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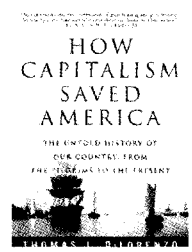

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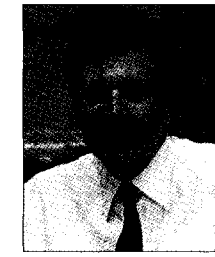
Another National Disaster in the Making: Government Reconstruction of New Orleans



BY RICHARD M. EBELING

Hurricane Katrina destroyed much of New Orleans at the end of August. What followed was a further disaster in the form of government incompetence and confusion at the local, state, and federal levels. Rarely have we seen a better instance of what Austrian economist Ludwig von Mises once rightly called "planned chaos."

Now America is faced with another national disaster in the making: the government's plan to reconstruct New Orleans and surrounding areas. After weeks of condemnation of government failure in handling the immediate and calamitous aftermath of Katrina, there has been an almost unanimous insistence that government socially engineer the redesigning and rebuilding of southern Louisiana.

After quickly approving over $60 billion in "aid" and "relief," the Bush administration and Congress are determined to demonstrate their "concern" and "leadership" by spending hundreds of billions more in taxpayer dollars on the "new" New Orleans. What can be expected are waste, corruption, and misdirected investment.

Invariably, the twisted hand of politics will be at work in determining how and for what those mountains of tax dollars will be spent. The "public interest," in whose name the expenditures will be made, will be the cover for government spending on programs and projects that will serve the interests of the federal, state, and local politicians desiring to create the right public-relations impression in the eyes of constituents, and feed the various special interests to whom they are tied. Contractors, construction companies, architects, and sundry other suppliers and producers will all be drawn to the horn of plenty. The land of Huey Long will once again show that "friendships" and "good old boy" connections can sure mean a lot.

At the same time, ideological and racial pandering undoubtedly will have its place at the broad table of government spending. Reconstruction proposals will abound with references to environmental awareness and minority-group sensitivity in deciding where, what, and how to rebuild. All resulting decisions will, of course, be "rationally" made—on the basis of prospective vote counting in future elections.

Some of the more "conservative" politicians are already emphasizing that they don't want direct government planning. They propose using tax incentives and selective modifications in employment and other regulations to induce "private sector" initiatives to make the New Orleans area more attractive for investment and rebuilding. In fact, this is nothing more than what in France is known as "indicative planning": the manipulation of tax breaks to induce private enterprise to direct its activities to those areas that the government wants to foster. Regardless of what it may be called, it remains political planning of economic affairs.

The degree to which liberty is little appreciated or understood in contemporary America is shown by the virtual absence of any voices calling for getting government out of any reconstruction of New Orleans. We have moved a long way since 1870, when the American economist (and mathematician and astronomer) Simon Newcomb could summarize what he took to be the common-sense ideal of what he called "The Let-Alone Principle":

> That each individual member of society should be left free to seek his own good in the way he may deem best, and required only not to interfere with the equal rights of his fellow-men. . . . The real point in dispute between the friends and the opponents of free government and individual liberty is simply this: Is man a being to be taken care of, or is he able when protected in his rights to take care of himself better than any governing power—congress, king, or parlia-

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ment—can take care of him? The advocates of universal freedom claim that, if each individual is protected in the enjoyment of his individual rights as a responsible member of the community, he can take care of himself, and manage his own affairs and his share of the public affairs better than any other one else can do these for him.

And Newcomb concluded that government "interference is so apt to lead to unforeseen complications,—that the best course for a government to follow is, to adhere to the let-alone policy as a matter of principle."

The "unforeseen complications" from government intervention, to which Newcomb referred, results from the fact that neither politicians and bureaucrats nor their consulting "experts" have the knowledge, wisdom, or ability to direct the affairs of men better than can be done through the free interplay of market processes.

Should New Orleans be rebuilt? And if it is to be rebuilt, how, where, and with what changes to the terrain? Newcomb also reminded his readers, in 1870, that in the marketplace each individual's judgment "will be sure to take into account a great many minute but necessary details which those who have nothing at stake might easily overlook." Why? Because "nothing sharpens the faculties and dispels prejudice as effectively as self-interest, and that no one will judge so well of an enterprise as he whose pecuniary interests are staked upon it."

Other People's Money

Politicians and bureaucrats are spending other people's money collected through the tax system. Their interests diverge from those of the taxpayers who are plundered to finance such a vast "public works" project as the reconstruction of New Orleans. The waste and corruption that follow are part of the inescapable "costs" of the business of redistributive politics.

If the future of New Orleans were left to the free market, it would be both the returning residents and all the other citizens of the country who would decide, through their work, saving, and investment choices, what shape any new city should take. Is a "new" New Orleans desirable and profitable as a site for commerce, tourism, and trade? What type of rebuilding should be undertaken and at what pace? And what alternative uses for society's scarce resources should be forgone around the country so they may be diverted to this reconstruction?

Some businessman in Michigan might decide that expanding an existing industrial facility in his home state should be delayed so he can take advantage of the greater profits anticipated by rebuilding a plant in southern Louisiana. The expected higher return from restoring a tourist hotel in New Orleans might prompt a shifting of investment capital that otherwise would have financed a new business in Oregon. An individual in New York might withdraw his savings from a local bank and go into partnership with others wanting to repair and operate a shipping facility in the port area of New Orleans, or to rebuild residential housing in or around the city.

> Now America is faced with another national disaster in the making: the government's plan to reconstruct New Orleans and surrounding areas.

Each of these decisions, and multitudes of others, would be made by the people themselves based on what they viewed as the best use of their scarce resources. Each decision-maker would minimize the cost of his actions in terms of what alternative useful consumer products would have to be forgone.

These individual decisions would set to work the creative and industrious energies of tens of thousands of people across the land, who would be motivated to act with as much wisdom and judgment as they could muster, since each person would be investing in his own financial future.

How much better to apply the knowledge and abilities of so many through their free choices rather than to limit the possibilities to the handful of political puppet masters in Washington, D. C., and Baton Rouge!

We can do the former if we only recapture the wisdom of the "let-alone" principle.

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Perspective

One Size Fits Some

The nonhuman part of the world makes sense. I expect no less of the human part. So let's explore the following true-life experience:

You're sitting in an airliner that has just landed and is taxiing to the gate. The flight attendant comes on the public-address system to say, "Welcome to New York's LaGuardia Airport. Please remain seated until the captain has turned off the seat-belt sign. You may now use your cell phones. All other portable electronic devices [as though you would be carrying nonportable devices] must remain turned off."

What is perplexing about this announcement is that the one and only electronic device you are now permitted to use is the one you were not allowed to use throughout the flight, and the devices you *were* allowed to use in flight may not be used now. That makes no sense.

If cell phones, as we're told, pose a threat to airliner communications, why isn't that the case while the plane is on the ground? And if Gameboys, iPods, and portable DVD players don't interfere with communications at 30,000 feet, why do they do so at zero feet? Are we being told the whole truth?

Another thing that makes no sense is why a rule—the one banning cell-phone use in flight—that is described as an aviation safety precaution was promulgated by the Federal Communications Commission (FCC), not the Federal Aviation Administration (FAA). The FAA oversees safety in the air. The FCC governs the broadcast spectrum. To be sure, the FAA supports the ban, but it is nonetheless an FCC rule. And it is the FCC that has invited public comment on the proposal to eliminate that rule.

A theory that makes sense of at least some of these puzzling facts is that the ban is not about safety at all. Perusing the newspapers and magazines, I find that no evidence supports the charge that cell phones pose any threat to communications. According to a 1999 *Wall Street Journal* story: "In 1995, [Boeing] engineers at the aircraft maker conducted a four-hour test on a 737, setting up about 20 cell phones throughout the jet and monitoring the plane's radios, navigational equipment and other controls. A variety of flight conditions were simulated. The results: 'Absolutely nothing,' says [Boeing senior electromagnetics engineer Bruce] Donham." One writer wonders why risky phones would be permitted in airport terminals and

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parking lots. *USA Today* reported last year that American Airlines and the phone maker QualComm performed a successful FCC/FAA-approved test over west Texas.

If the ban is not about safety, what then? Money, perhaps. Various articles report that using cell phones in airliners can, with current technology, disrupt cellular service on the ground. I also read that it would be hard, again with current technology, to bill cell-phone customers who are moving between towers at 300 miles per hour. Then there are those pricey AirFones installed in the seats that the airlines want us to use. Why pay a minimum $2 a minute if you can use your own phone? (Apparently most people prefer no phone at all to one at that price.) Is the FCC ban a safety cover for financial interest?

Which brings us to the question: should passengers be allowed to use cell phones on airliners? At least that's the question people are asking as they divide themselves into productivity and can't-we-have-peace-anywhere? blocs.

But it's the wrong question. The appropriate question is: who should decide? That's the right one to ask all the way down the line. If the airlines and plane manufacturers can't determine if cell phones pose a danger to their equipment and customers, then the FAA is nothing but a fig leaf. It would be powerless to protect us from such incompetence. But in fact those private companies *can* decide the safety issue. As noted, they already have.

As for letting passengers use their phones, why assume there is only one answer? Here in living color is the presumptuousness of the regulatory state. It arrogates the authority to determine the Right Answer and then to impose it on everyone.

The controversy over cell phones on airliners arises from a clash of preferences. Some people want to talk on the phone while flying. Others don't what to hear telephone chatter. (One wonders if chatter between two seatmates is so different—but I digress.) No one knows the full business implications of permitting passengers to use cell phones. So why not let the airlines, individually, find out? Some will stick with prohibition. Others will permit open use. Still others will set up cell-phone sections. All will cater to anticipated passenger tastes, and the consequences will play themselves out in the competitive marketplace, which is a great teacher.

Imagine that! Freedom leads to the best combination of outcomes.

★ ★ ★

The lion's share of this issue of *The Freeman* focuses on the notorious case *Kelo v. City of New London*, in which the U.S. Supreme Court explicitly gave local governments the green light to revitalize their economies by transferring property, under the power of eminent domain, from one private party to another. Eminent domain, a vestige of absolute monarchy, under which the king owned his realm, violates individual rights. The problem is not that it has been abused. *It is an abuse in itself.*

Our contributors examine the ruling, and other forms of property deprivation, from several angles.

Richard Epstein points out that the outrageous decision grew out of an equally outrageous local redevelopment plan that didn't even require the taking of private homes.

George Leef challenges the Supreme Court's assumption that economic revitalization is a proper function of government.

Steven Greenhut surveys the public reaction around the country to the decision and the heartening determination to prevent such takings from occurring in other states.

Eminent domain isn't the only way that government can interfere with a landowner's property rights.

As Gardner Goldsmith points out, local governments are fond of using their borrowing power to acquire open land in order to prevent development.

And Paul Messino tells the story of a man whose property rights fell victim to North Carolina's municipal-incorporation laws.

This special issue culminates with an article by Andrew Morriss on why the rule of law is important—and so badly misunderstood.

From our columnists we have the following: Richard Ebeling urges private reconstruction of New Orleans. Donald Boudreaux adds his own take on *Kelo*. Stephen Davies contrasts the reputations of warriors and merchants. Russell Roberts revisits supply and demand. And Arthur Foulkes, seeing charges of market failure leveled at capitalism, responds, "It Just Ain't So!"

Our book reviewers pass judgment on tomes about the Austrian and Chicago schools of economics, capitalism's record, the ominous expansion of the criminal law, and intergenerational rivalry.

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Regulations Improve the Free Market? It Just Ain't So!

BY ARTHUR E. FOULKES

Despite its remarkable record the free market remains for many people a tough sell. Even those who on balance support free enterprise hesitate to give unregulated market forces their full endorsement. After all, they argue, the market sometimes "fails," requiring corrective measures at the hands of wise government authorities.

One such qualified endorsement of market freedom appeared last May in a syndicated column by Knight Ridder journalist Jeff Brown. After remarking—paraphrasing Churchill—that "a market economy is the worst system—except for all the others," Brown goes on to list several examples of what he called "market-force failure." His examples include real-estate commissions, medical costs, credit-card interest rates, and CEO compensation. Each has remained "high" he says, despite increased supply, increased competition, or both. Regulatory intervention, he concluded, is therefore justified.

Brown argues that the real-estate market has "failed" because commissions have "held at 6 percent for ages," despite what he asserts is "a huge oversupply of brokers." But the truth is, as housing prices have soared (in many areas) and more competitors have entered the real-estate business, commissions have been falling. According to a survey published by REAL Trends, an information and consulting firm for real-estate professionals, average 2002 commissions were only slightly above 5 percent nationwide—down from about 5½ percent the year before. Many home sellers are using newly formed "flat rate," or discount, realty companies, while others are opting against using an agent at all. In response, even some old, well-established firms, such as Coldwell Banker, have started experimenting with heavily discounted commission rates.

It is true that some consumers may continue to pay 6 percent commissions, but even this is not due to "market failure." They may prefer an excellent broker who can insist on 6 percent (or more), or they many not like to haggle.

An even less likely place to look for market failure is in the U.S. medical market. Certainly there are glaring—even tragic—distortions in this market, but they are in no way a result of the free market. On the contrary, the significant economic problems associated with medical care all stem from government interference with the market.

For instance, a government-backed cartel has long sought to keep the supply of doctors and medical services low relative to demand. A single paragraph from an article in *USA Today* (March 2) nicely sums up the problem: "The marketplace doesn't determine how many doctors the nation has, as it does for engineers, pilots and other professions. The number of doctors is a political decision, heavily influenced by doctors themselves."

Until recently professional medical organizations, including the highly influential American Medical Association (AMA), have warned of a doctor surplus in America. Only lately have these organizations admitted that the feared doctor glut was an illusion. As Richard Cooper, director of the Health Policy Institute at the Medical College of Wisconsin, told *USA Today*: "We face at least a decade of severe physician shortages because a bunch of people cooked numbers to support a position that was obviously wrong."

On top of this, licensing laws drastically restrict the supply of medical services. Working through state and

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federal lawmakers for over 100 years, the AMA has managed to sharply restrict the number of approved medical schools as well as prevent nonphysicians, such as homeopaths, nurse practitioners, midwives, and chiropractors, from legally performing medical services they are otherwise qualified to administer.

Meanwhile, the demand side of the medical market is also seriously distorted. As a result of Medicare, Medicaid, and government tax incentives for employers to provide low-deductible medical insurance, few Americans pay for care out of pocket. This artificially inflates consumer demand.

Thus there is no market failure in medicine, only a double squeeze on market participants from both the supply and the demand side.

Credit-card interest rates are another area of apparent market failure, according to Brown. In his words, "Many credit cards carry interest rates in the teens even though consumers have lots of choice and other interest rates have been at rock-bottom levels for years."

A recent Federal Reserve Bank of Chicago study noted several market-based reasons for relatively high rates, including the risk to banks of unsecured loans and a propensity for consumers to disregard credit-card rates because they believe (wrongly in many cases) they will pay their balances in full each month. (See www.chicagofed.org/consumer_information/controlling_interest.cfm.)

Still, the same report noted (just as economic theory would suggest), real or perceived "high" profits in the credit-card industry have attracted "a host of new competitors" who have intensified "competition in terms of both service and price." This has come in the form of lower interest rates, "buyer protection plans," rebate programs, and mediation services in the event of a conflict between buyers and sellers. (See J.H. Huebert, "Free-Market Justice Is in the Cards," *The Freeman*, April 2005.)

It is also possible to argue that—at a fundamental level—central-bank (that is, government) intervention in the overall credit market has also contributed to today's relatively high credit-card rates. By artificially lowering interest rates in recent years, the Federal Reserve has made interest-bearing assets, such as bonds, less attractive and, conversely, made present-oriented consumption more attractive. The resulting heightened demand for spending means greater demand for (and thus higher prices for) credit-card and other types of short-term consumer borrowing. In this way, the Fed can be seen to have indirectly increased credit-card rates even while keeping other rates down.

Executive Pay

Finally, Brown points to executive compensation as another area of market failure, noting that CEO pay "continues to soar" while there are "legions of managers who'd do anything for shots at the top jobs."

Here Brown is touching on what economists call the "agency problem." Because individual corporate shareholders have little incentive to spend the time and effort to monitor executive pay, corporate managers, it is said, are in a position to greedily extract huge salaries.

> The market has its own solution to the agency problem; it's called the "hostile takeover."

Yet the market has its own solution to the agency problem; it's called the "hostile takeover." When a company is poorly managed, outside investors ("raiders") begin buying shares of the company from ready-to-sell shareholders. Once a takeover is complete, the new owners dismiss the poor management and replace it with their own. Thus the takeover is the shareholder's best defense against bad management.

But, alas, terms like "hostile takeover" and "corporate raider" have helped give this market process a bad name, while powerful CEOs have been able to persuade national and state lawmakers to severely restrict the takeover process. Again, government intervention—not market failure—is the root of the problem.

Brown ends with an appeal for new government regulations, although most of the problems he identifies have their roots in previous government regulations. These regulations have created waste, politically driven wealth redistribution, and other harmful market distortions. More government intervention is not the answer; freedom is.

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A Popular Insurrection on Property Rights

BY RICHARD A. EPSTEIN

The property rights issues that arise constantly in modern life are always difficult and often obscure. Most ordinary people understand the importance of zoning restrictions and environmental protection in their daily lives. They are also keenly aware that the state exercises its eminent domain power whenever it condemns land for a post office or a public highway. But in general they rightly feel a little intimidated if asked to understand the inner workings of a legal system that is dominated at every turn by an impenetrable jargon that even trained lawyers find it hard to manipulate. So they tend to express their satisfaction or disapproval with various cases in global fashion that avoids judgment of their legal merits: do the actions of governments, usually at the state and local level, tend to advance some legitimate cause? They couldn't care less about the fine points of exactions or whether imposition of a conservation easement counts as a regulatory or a possessory taking.

There are occasions, however, in which that resigned complacency is replaced by a collective gasp of indignation that sounds a clarion call for action. The two key conditions for a popular uprising are not easily satisfied. First, the government action has to be simple and direct, so that it hits people right in the gut. Second, it has to be an affront to a constitutional provision simple enough for everyone to understand. Outrageous actions that are flatly illegal do produce a firestorm of protest by ordinary citizens turned constitutional lawyers.

There are few cases in which this explosive mix seems to occur. It certainly happens with school prayer, abortion, and affirmative action. But land-use planning and condemnation has been such a fixed feature of our urban landscape for so long that is hard to believe that it could trigger that kind of social firestorm. But it did, big time, on June 23, 2005, in *Kelo v. City of New London*. That case catapulted private property rights into the top position of American problems, according to a *Wall Street Journal*/NBC poll. And why? Because a regrettable decision of the United States Supreme Court upheld an ambitious land-use planning scheme that the City of New London devised with the ostensible purpose of reviving the flagging fortunes of a small Connecticut city that had fallen on hard times. One portion of the plan, viewed in its most favorable light, authorized the condemnation and destruction of a number of family homes, with payment of compensation, which is always set below the actual loss to its owner—which is another, related, story. The land was to be transferred to private developers for use to promote general economic development, create jobs, and increase the tax base of the town. In its original inception, these were no modest aspirations: luxury hotels, fancy apartments, upscale stores, and wishful thinking.

> *Kelo* required the Supreme Court to construe three little words, "for public use," in the Takings Clause to the Fifth Amendment.

Kelo required the Supreme Court to construe three little words, "for public use," in the Takings Clause to the

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Fifth Amendment, which is short enough to quote in full: "nor shall private property be taken for public use, without just compensation." A five-member "liberal" majority led by a determined Justice Stevens (who like Will Rogers has never found a government spending program he did not like) upheld the project. Justices Souter, Ginsburg, and Breyer happily signed on, and Justice Kennedy waffled a bit, but went along nonetheless. Their bottom line: any project that had some indirect public benefit in the eyes of the city elders was sufficient. The project could go forward. Four conservative justices, so-called, Rehnquist, O'Connor, Scalia, and Thomas, signed on to pointed dissents that castigated the Court for making the public-use clause a dead letter.

Outrage is the only way to describe the public reaction. (See, for one account, Timothy Egan, "Ruling Sets Off Tug of War Over Private Property," *New York Times*, July 30, 2005, p. A1.) I had written on behalf of the Cato Institute (with Mark Moller) a brief that had decried the action of New London. For my pains I was besieged with phone calls from legislative aides in the United States Senate, California, Florida, Illinois, Missouri, Texas, and perhaps some others, who were determined to pass some constitutional or legislative fix that they thought would undo the massive damage that the *Kelo* decision did to their fundamental institutions. Legislation is pending just about everywhere. The U.S. House of Representatives condemned the decision by a vote of 365 to 33, with the likes of Tom DeLay and Maxine Waters at last finding common ground. Quite simply, they were all pushed by ordinary citizens who do not care one way or another whether John Locke had the right explanation for the origin of private property. But those folks went ballistic over the proposition that the state could take their lands simply to transfer them to someone who was richer and more powerful than themselves. Conservatives who believe in property and populists who dislike pushy corporations made a common cause.

> The first important lesson of this sorry exercise is that the principle of a strict construction often *requires* the invalidation of laws that violate an express constitutional prohibition.

After the Supreme Court decision, moreover, the New London Development Corporation only added fuel to the fire, both by serving eviction notices on the *Kelo* defendants and demanding back rent from them for the interim period of occupation. Those steps brought howls of protest from Connecticut Governor Jodi Rell and the New London Council, which announced that at long last it had lost confidence in its Development Corporation. At last word, the eviction orders have been rescinded and the rental claims dropped. Indeed, at the eleventh hour, even the status of the ill-starred grand plan is in issue. Stay tuned.

Since the worst thing that anyone can say about a Supreme Court justice is that he or she has engaged in the sin of judicial activism, Justice Stevens and his progressive liberal crew were quickly branded with that unseemly label. The four conservative horsemen, almost by default, now became the redoubtable defenders of the common man.

This whole overheated picture requires some unpacking—but none that will restore respectability to the dreadful mishmash in the Stevens opinion. First off, the phrase "judicial activism" should not be hurled around as an uninformed epithet, but should be given some precise meaning, along with that of its sometime traveling companion, the canon of "strict construction" of the Constitution. In its original inception these two concepts were thought to be closely entwined. The judicial activist was a judge who usurped legislative functions by invoking exotic conceptions of constitutional interpretation. Thus efforts to take over school systems and to pass legislative appropriations for prisons do count as instances of judicial activism. The activist judge strikes down legislation that democratic bodies have properly passed after due deliberation.

No Judicial Activism Here

But however grievous the sins of *Kelo*, "activism" is not the word to describe them. Quite the opposite,

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in *Kelo* Justice Stevens performed judicial somersaults to allow the city to go forward with its comprehensive plan to rip down the houses. He was too *soft* on government, not too hard. But strict construction raises a different flag, for how could the words "for public use" be read to allow the state to take land that was headed by design straight for private ownership and private use, whereby its new owners could exclude the entire world if they so chose. The first important lesson of this sorry exercise is that the principle of a strict construction often *requires* the invalidation of laws that violate an express constitutional prohibition.

Here it does not take a great lawyer to realize that the phrase "for public use" does not easily translate into "for private use, so long as there is any 'conceivable' indirect benefit from a planning scheme hatched by City of New London and its privately created Development Corporation." More simply, every private home generates some public benefit, so that any time property is taken from A to B, it meets the capacious test of public use. That perverse rendering just writes the words out of the Constitution.

The abuse of legal doctrine is not something new: it is an inseparable part of Supreme Court jurisprudence. But in this instance, the judicial misadventure hit home. Justice Stevens lives in the thrall of a Progressive worldview that sees only good when the bulldozer knocks down a private home. The traditional view that property is the central institution for preserving and promoting the settled expectations of ordinary people is a view that has commended itself to such outdated thinkers as Locke, Hume, Smith, and Bentham. But ironically it was just that view that resonated so powerfully with people on all sides of the political spectrum, many of whom never heard of any of these eminent thinkers to whom they owe such an enormous debt. They could not see the wisdom or justice of throwing folks out of their homes to make way for the richer folks who could take their place.

Indignation in this case is a wonderful tonic because it wakes people up to the dangers that government can pose to institutions that they take for granted.

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it wakes people up to the dangers that government can pose to institutions that they take for granted—which is itself a phrase taken from general property law. Indeed, if they had stopped to look at the particulars of the *Kelo* situation they would have been still more appalled. The best that could have come out of that sorry exercise in city planning was that the land on which the homes of Ms. Kelo and her fellow landowners sit would be occupied by fancier homes with a fine view of Long Island Sound. In fact the blundering planners of New London did not contemplate that the land would be used for that purpose. Rather, it was set aside for "park support services" that no one could define.

More generally, it turns out that this particular plan is best described as a "nonplan." The city had full control over about 90 acres of property that were already in its possession; it had spent about $73 million in state funds to build infrastructure, do environmental cleanup, and engage in long-term planning. The only problem was that it did not have any private developers who were committed to putting any particular project on the land that it already owned! As often happens, there is a competition for development between different localities in the same region. And while New London dithered over its "plan," smaller parcels of land outside of city limits had been turned into the hotels, shops, and office buildings that scooped the ones New London had hoped to put on its land. The houses were, for the most part, a sideshow, which never stopped the main plan anyhow. The plan that it had could have gone forward if those houses had just been left alone and not slated for senseless destruction on spec. Property is not taken for public use when the state has no idea *why* it is taken.

So What Do We Do Now?

Faced with so outlandish a decision, it is no mystery that people wonder when they go to sleep whether they will own their homes in the morning. The one silver lining in Justice Stevens's opinion was that he noted that state legislatures could include in their constitutions

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and statutes protections that are more extensive than those (paltry) protections that he found in the public-use provision of the Takings Clause. So the rush begins. Just what should be put in place of the despised *Kelo* ruling? And it is here that the job gets a lot more complicated. One key feature of the public-use language is that it does not specify at all what kind of property is taken. Yet to most individuals, *Kelo* would be just another property-rights case if the City of New London sought to take a vacant lot, abandoned store, or even farmland for public use. Sentiment would be more divided if it were a small business, or perhaps even a large one. But it is not so clear that the Constitution embeds in the public-use clause these very sensible judgments that some forms of property are more personal than others, and thus should receive a higher level of protection. Yet at the same time, a provision that says that private homes should never be taken for public use runs into difficulties the other way: do we really think that under no circumstances a private home should ever be taken for a public road, a hospital, or even an office building? There is only so much weight that we can place on three little words.

The situation becomes more clouded when we look to the historical evolution of the public-use language. The recent decisions before *Kelo* did not speak well for the intellectual or political acumen of the Supreme Court. Its 1984 decision in *Hawaii Housing Authority v. Midkiff* involved a Hawaiian scheme whereby individual tenants would place money in the public treasury that the state government would then use to condemn (on the cheap of course) the landlord's interest in the same property. It looks to be as clean an illustration of taking from A to give to B as one could imagine. But a unanimous eight-member Supreme Court (Justice Thurgood Marshall did not participate) meekly caved in with a dreadful decision by (a then-compliant) Justice O'Connor, which found that Hawaii had "conceivable " indirect public benefit in using the eminent domain power to counteract a supposed "oligopoly" problem that confronted the worthy Hawaiian Islanders. (It was largely attributable to its restrictive zoning laws, but that is another story.) The decision rested on the same flabby rule of constitutional deference as *Kelo*, but it engendered no public outcry at all. Why? Because no sitting tenant was knocked out of his home, and the chief landlord was the powerful Bishop's Estate. The populists didn't care.

Department Store Taken

Much the same can be said of an earlier decision that proved more important in the *Kelo* decision. The 1954 decision in *Berman v. Parker* involved a comprehensive plan to clean up a blighted area in Washington, D.C., by removing all the structures in a large district. Berman's department store was located in the region, but was itself not blighted. No matter, said Justice Douglas for a unanimous court. All sorts of aesthetic benefits (which he blithely assumed that the planners could create) counted as a sufficient public benefit, so that Berman had to take the dollars and shutter his store. But again, no real outrage. Ordinary people don't identify with blighted neighborhoods or small department stores, and besides the real dangers of bad urban planning were less apparent then than they are now.

Nor did the public react in 1981, when the city of Detroit, with the blessing of the Michigan Supreme Court, took an entire unblighted old ethnic neighborhood, Poletown, so that General Motors could build a Cadillac factory. In many ways the level of disruption of ordinary life was far greater than it was in *Kelo*, so it is critical to ask why the lack of some national backlash like that which *Kelo* has spawned. Two points come to mind. First, Poletown was a local matter; the case did not reach the U.S. Supreme Court. And second, at the time, there was no organized property-rights movement and certainly no campaign against eminent-domain abuse, as there is today. In an age of raised sensitivity, *Kelo* brought together intellectual conservatives who fear state power with progressives who think that state power should be used to bring communities together, not rip them apart.

The complacent tone of Justice Stevens's opinion in *Kelo* gave no hint that he (or anyone else, for that matter) was aware of the looming public outcry. But the anguished cries of protest clearly stung him. In a rare moment of public unhappiness, Stevens stated at a Las Vegas bar association meeting that he did not like the outcome in the *Kelo* decision, and thought that the free market was the best way to redevelop land. But,

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nonetheless, he concluded that he had no choice but to apply the judicial precedents that required *Kelo's* unhappy result. The Justice was half right. There's no question but that his decisions were *consistent* with earlier dreadful decisions. But there was no way to say that the results were *required* by them either. Here are three quick grounds of distinction. *Kelo* was the first case that involved the condemnation of private homes; it was the only case where the so-called comprehensive master plan specified no use for the condemned property; and it involved neither blight nor oligopoly. Stevens could have protected the *Kelo* defendants, and, ironically, defused the widespread challenge to the use of eminent domain to further development or enlarge the tax base. So what's next?

Constitutional Interpretation and Public Trust

At this point, however, the complexities start to build up. Is the removal of real (hard-core) blight—the sort we know when we see it—sufficient reason to take land? Or is it a reason to raze the building as a public nuisance, while leaving the land in private hands? These choices are a lot tougher than the issue raised in *Kelo*. The same is true of the earlier line of cases which said that certain takings for (gasp!) private uses were all right because of the great public benefit they created. No, these cases were not early trial runs of *Kelo*. Typically they involved scrublands that lay between a productive mine and the railroad tracks that had to be reached to ship the ore to market. The danger was that owner of the scrubland would hold out for a small fortune and block the use of the mine. In other nineteenth-century cases, mills could only be created by flooding private farmlands, so that the same holdout problem existed. Cautiously, early courts tended to allow these takings for just compensation when the high-holdout problem was conjoined with the low subjective value of the scrubland (or farmland) taken for what looks like a private use, with some real public benefit.

That balancing test does not sit well with the dogmatic frame of mind that takes hold when all people think of is what they can do to prevent outrages like *Kelo*. And this shows a hidden danger of really bad interpretation in easy cases as opposed to really tricky interpretation in harder cases. I see no reason why any court or legislature would want to overturn the results in the holdout cases, which have done useful work for 150 years or more.

Unfortunately, precipitate action often goes further than it ought. And that is just another cost of bad case law in *Kelo* and its forebears. No constitutional language is so crisp that it does not admit hard cases. The language of public use was introduced to signal that certain kinds of takings were just off limits. No three words in the English language are better adopted for that result. But three words are not a complete land-use code, and they cannot take into account all the factors that on reflection should decide when property is just off-limits to government action and when it can be taken with just compensation. Similar issues exist with every other word of the Takings Clause: what is private property, how is it taken (or destroyed or regulated), when is it permissible to do so?

Constitutional texts are sensible and vital starting points for complex analysis. It takes literally a volume to sort out all the difficulties that arise with any open-ended clause of our Constitution while remaining faithful to its central purposes. The great constitutional tragedy of *Kelo* is that the subtle element of trust between the justices and the public has been shattered by a decision so wrongheaded that people think that they have to take the law into their own hands. It will be a long time before that trust is restored no matter what the Court's composition. Overruling *Kelo* would be a good way for the Supreme Court to begin.

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Kelo v. City of New London: Do We Need Eminent Domain for Economic Growth?

BY GEORGE C. LEEF

The first piece I ever wrote for *The Freeman* was about the U.S. Supreme Court's indifference to political actions that deprive people of their liberty and property ("How Did We Lose Our Freedom?" June 1977). Sadly, the Court continues to give politicians free rein to trample the rights of individuals—except in cases where the justices think that the rights are "fundamental." Property rights are not regarded as fundamental, and the Court will accept almost any justification, no matter how naïve and intellectually feeble, for government encroachments on them.

In *Kelo v. City of New London*, decided on June 23, 2005, the Court continued that depressing tradition. The case centered on the decision of New London to seize the property of a number of homeowners for a planned "redevelopment" of a waterfront area. The houses were perfectly habitable, but the city wanted them for what it envisions as a glitzy area of corporate offices, a hotel, and upscale shops. Susette Kelo and others tried to fight the condemnation in the local political arena, but when they couldn't get the city to relent, they turned to the courts. The Connecticut Supreme Court ruled against them 4–3, finding no legal bar to the city's plan. Kelo, aided by attorneys for the Institute for Justice, appealed to the U.S. Supreme Court, arguing that the Fifth Amendment allows for the taking of private property only for "public use" and the New London plan would merely entail a different private use.

Advocates of freedom regarded this as an important case. Would the Supreme Court put an end to the widespread practice of seizing private property for no reason other than that politicians calculated that higher tax revenues would be collected if a tract were owned by a large commercial enterprise instead of a homeowner or small business? Alas, no. Rather than reading the Constitution's clear language as it was intended—and simultaneously ending injustices from coast to coast—the Court decided to defer to the judgment of politicians as to which property confiscations are "for the public benefit." Justice Stevens, writing the majority opinion, said that economic development was a "traditional function" of government and the Court would intervene only if a taking were clearly motivated by a desire only to enrich another private party. Since politicians are clever enough to always swaddle their property seizures in a blanket of supposed "public interest," the ruling really gives politicians a free hand with regard to the use of eminent domain.

> *Kelo* is bad constitutional law as well as bad public policy.

The language of the Fifth Amendment is clear. Government may take private property for "public use," providing it pays "just compensation." (Of course, libertarian philosophy objects to any "takings" and points out the incoherence of just compensation in coerced transactions.) Given the solicitude of the Framers for private property and their insistence on strictly limiting government power, the notion that land seizures for economic development (or "revitalization" as it's often put) comport with the Constitution is patently absurd. Let us imagine that in 1805 New Lon-

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don had sought to take the home of a resident in order to assemble enough land for the construction of a new hotel. Most of the signers of the Constitution were still alive then. If they had been asked whether the taking was permissible, very few, if any, would have said, "Sure—we must defer to the wisdom of politicians as to the best use of land in their jurisdiction."

But most of the Court's current members are not originalists. What the men who wrote the Constitution meant by their words is not, in their view, determinative. They believe instead that the Constitution must be constantly reinterpreted in light of "modern conditions," a locution that nearly always justifies the ratcheting up of government power.

Here, the supposed need for government action to "grow the economy" (as Bill Clinton used to say) is enough reason to allow politicians to bulldoze modest houses to make way for big commercial developments. If local officials think that there will be a "public benefit" in transferring title from A to B, that's enough to satisfy the public-use requirement. Justice O'Connor was surely correct in dissenting, "Under the banner of economic development, all private property is now vulnerable to being taken and transferred to another private owner, so long as it might be upgraded—i.e., given to another owner who will use it in a way that the legislature deems more beneficial to the public—in the process." Another barrier between the citizen and the power of the state has been swept away, but the Court's majority sees no problem with that. After all, we're only talking about property rights here.

Susette Kelo
Photo by Scott Frank, 2004 © Institute for Justice

Crucial to the Court's opinion is the notion that economic development is an important government function, one with which judges should not interfere. In pledging their deference to elected officials, the justices continued a long line of cases where the Court chose to leave citizens at the mercy of politicians so long as "only" economic liberty and property are involved. What all those cases and *Kelo* have in common is the central belief in the need for and general beneficence of government regulation of the economy. To modern liberals, the idea of a society guided by nothing more than Adam Smith's invisible hand of self-interest (and constrained by the general rule of law) is frightful. Government simply *must* do far more than the few "night watchman" functions that classical-liberal theory calls for. Government needs to be *active* in many ways, including providing employment opportunities for the people.

Sphere of Voluntary Action

Economic development is certainly is not a "traditional" function of government. Only within the last few decades has that idea taken root, an idea planted by politicians eager to expand their power. Traditionally, the job of government was to maintain order and provide those few services that the free market supposedly could not, such as roads. During our long period of *inactive* government, the American economy grew rapidly, owing to the work and investment of individuals. Those are endeavors that take place within the sphere of voluntary action rather than coercion, which is the only tool in government's box.

Economic development occurs when free people wisely invest their labor and capital to increase the production of goods and services. All government needs to do is to stand ready to enforce the laws of contracts and property. Just as salt crystals form spontaneously once conditions are right, so does economic development occur spontaneously when conditions are right. Government action can (and often does) hinder or prevent development, but if it does not, the strong human propensity to improve living conditions will prevail.

But don't modern conditions call for government to step in? Consider poor New London, which was designated a "distressed municipality" in 1990 by a Connecticut state agency following years of economic decline. After the closing of a Navy facility in 1996, the city continued to lose population and suffer from a relatively high rate of unemployment. New London is less prosperous overall than it was previously. That is assumed to be a *political problem* requiring local officials to take

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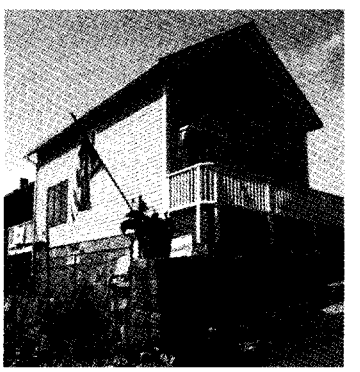
action to bring back jobs and prosperity. The Supreme Court buys that idea. It is, however, erroneous.

New London, or any political unit, is an amalgamation of the individuals who live there. Just as the circumstances of individuals can change with shifting events, so do the circumstances of cities. Cities no more have an entitlement to a particular level of prosperity than any individual does. If conditions change adversely, the individuals who are affected will adapt as best they can. Clearly, that has happened in New London. Some residents moved away, seeking better-paying work after the Navy facility closed. Others adapted in different ways. For many, life has gone on the same as always.

The decline of New London is not akin to some rampaging plague that must be cured. It's merely a change in circumstances to which free people are capable of adjusting. Government officials have no reason to seize the property of some in order to try restoring the former level of incomes—and, of course, the tax haul.



Susette Kelo's New London home

Photo by Isaac Reese, 2004 © Institute for Justice

A Negative-Sum Game

Even if economic development doesn't need government assistance through eminent-domain land seizures, still isn't it better to have more of it? Aren't people going to be more prosperous than otherwise if cities can facilitate new investment by making it less expensive for companies to locate within their borders?

That seductive argument overlooks one of the fundamental concepts of economics—scarcity. There is only so much investment capital available, limited by the desire of individuals to save. Therefore if a city or other political unit uses subsidies such as low-cost real estate to lure business, at most that can only *redistribute* development. If a city uses eminent domain to attract a new hotel, shopping mall, or sports team the politicians deem desirable, other places will have less of those things. New London's apparent gain comes at the expense of other Connecticut or New England cities. Where is the "public benefit" in that?

Government-sponsored development is likely, moreover, to prove to be inferior to purely private development under laissez-faire capitalism. That's because capital is more apt to be wasted if it is invested either by government directly or in conformity with plans conceived by officials. While it's true that private investors can make mistakes and put money into ventures that fail, they are less likely to blunder, because they have to bear the full cost of the venture and bear the risk of failure. The history of government-sponsored economic development is littered with wrecks, a recent case in point being Britain's Millennium Dome. The more economic development is dominated by government planning, the more scarce capital will be squandered on projects that looked good to politicians eager for photo opportunities and campaign issues, but proved to be money pits.

Let us suppose that some economic-development project facilitated by eminent domain actually proves to be a commercial success. New London's waterfront plan might, of course, lead to the establishment of profitable businesses paying lots of taxes to the city. Then it would certainly be a "public benefit," wouldn't it? Justice Stevens wrote about the "carefully formulated" plan calculated to bring new jobs and increased tax revenue which "unquestionably serves a public purpose."

But is that right? One of the unexamined conceits of modern liberalism is that whatever augments the government's ability to spend is good. (Conservatives often play that game, too, contending that tax-rate cuts are beneficial because the result will actually be more revenue collected.) The idea that increased government spending is necessarily a public benefit needs some examination.

New London and virtually every city in the United States have enough revenue to perform all their core functions. Increased revenue, therefore, will be spent in ways that do little or nothing to improve, say, police protection or the condition of the streets. Instead, increased spending will inevitably benefit special-interest groups adept at feeding at the public trough—various consultants, contractors, public-school teachers and administrators, municipal employees, and so on. Politicians will always crow about the great benefits their spending brings the public, but the truth is that the average citi-

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zen doesn't detect the slightest change in the quality of his life whether government spending increases or decreases.

The Alternative

Rather than trying to directly stimulate economic development, governments need to concentrate on establishing the necessary conditions that will do the most to induce private investment. They do that by performing their essential functions as efficiently as possible and otherwise refraining from interfering with private decision-makers. The ideal economic-development plan for New London or any other city is to stop the incessant meddling with free enterprise. (True, many of those meddlesome regulations have been mandated by the states and federal government, but cities can gain a competitive advantage by not adding to the burden.)

Most American cities, especially older "rust belt" cities, have bloated budgets and a political culture hostile to free enterprise. An excellent example is Buffalo, New York, described in detail by James Ostrowski in *Political Class Dismissed* (which I reviewed in *The Freeman*, January–February 2005). Buffalo's high taxes and anti-entrepreneurial climate have made it an economic basket case. If city officials there or in other "depressed" cities are serious about economic growth, they need to break away from the deal-making frame of mind that equates success with reeling in an occasional investor with subsidies. Instead, they need to establish a climate of liberty where profitable enterprise isn't penalized.

Freedom optimizes economic development, but it takes place in ways that are largely unnoticed by the public and, for that reason, of no political value. A mayor would probably rather have an occasional, media-saturated ribbon-cutting ceremony for some big deal he arranged than hundreds of small private investments, but the latter is the path to the greatest prosperity for the people.

Kelo is bad constitutional law as well as bad public policy. It encourages cities to continue using the coercive, rights-violating method of eminent domain to subsidize the kinds of splashy, high-visibility projects that politicians favor. Had the Court given a decision that was faithful to the intention of the framers to put a strict limit on the use of eminent domain, homeowners like Susette Kelo would not have to give up their homes just because political schemers can devise what they think are "better" uses for their land. Now, unfortunately, cities have the green light to continue with a failed policy that robs from the less affluent to give to the more affluent. That a majority of the U.S. Supreme Court is willing to turn a blind eye to the meaning of the Constitution and give its blessing to abusive political power speaks very poorly of our so-called liberal justices.

> Allowing the government to take property solely for public purposes is bad enough, but extending the concept of public purpose to encompass any economically beneficial goal guarantees that these losses will fall disproportionately on poor communities. Those communities are not only systematically less likely to put their lands to the highest and best social use, but are also the least politically powerful.
>
> —*Justice Clarence Thomas*, dissenting, *Kelo v. City of New London*

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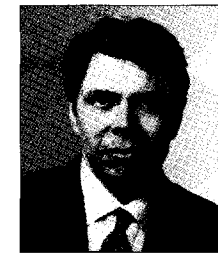

The Dangers of Eminent Domain

BY DONALD J. BOUDREAUX

In *Kelo v. City of New London* the United States Supreme Court greatly weakened the constitutional protections that property owners have enjoyed against governments wishing to seize private property. This weakening is unfortunate.

Because the facts of the case and the thrust of the ruling are now well known (and spelled out elsewhere in this issue), I'll not belabor them. Nor will I discuss the constitutionality of the ruling. Instead, I shall argue that even if the Constitution did nothing to prevent government from seizing property, such seizures are unwarranted *under any and all circumstances.*

The point seems almost too obvious to mention, but let's be explicit: the more secure people are in their property, the greater will be their efforts to create and improve property. And the greater are these efforts, the wealthier is society.

Not only are the persons who acquire, create, and improve property better off—but so, too, are those with whom they have even indirect commercial relationships. If Andy clears and fertilizes a field to grow more corn, he profits by selling his greater output—and corn consumers (even those who don't buy from Andy!) are made better off by corn's greater availability and lower price.

But if Bob gets the power to take Andy's property against his wishes, then Andy's security in his property is lowered. Andy reasons that further expenditures by him of his money or effort to acquire, create, or improve land for growing corn might be wasted because Bob can confiscate the property and, along with it, whatever sweat and wealth Andy invested in the seized property.

One result is reduced creation and improvement of property. People in their capacities as property owners suffer, of course, but they also suffer in their capacities as workers and consumers. Fewer and less-elaborate factories and research labs are built, meaning fewer higher-paying jobs are available. And businesses produce less output, and of lower quality.

Few people disagree with the above. "Of course!" they say. "But there are some legitimate projects that require government to exercise the power of eminent domain. Government is not like private men and women whose only motive for confiscating property is selfish gain. Government, at least when it is properly constituted and constrained, must have the authority to seize property in certain circumstances. Even the framers of the U.S. Constitution understood that government needs this power."

Even if the Constitution did nothing to prevent government from seizing property, such seizures are unwarranted *under any and all circumstances.*

Overwhelmingly, these supposedly special needs justifying the exercise of special powers are infrastructure projects that require the acquisition of large contiguous tracts of land. A road is the chief example. According to this view, if the social welfare is best served by building a road from point A to point B, then *all* the land along the route must be acquired.

The concern is that without the power of eminent domain, each owner of each parcel of land necessary for the road can scuttle the entire project. Suppose nine of the ten owners of the land necessary to build the road agree to sell their parcels to the government. But one owner holds out (either because he truly values the land at a price higher than the government is willing to pay, or because he supposes that by strategically holding out

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he can oblige the government to pay him an extraordinarily high price).

The result is that the road doesn't get built, or that it is built along an inferior route, or that taxpayers are "held up" for an extortionate sum by a greedy property owner. Because each of these options is inferior to the road being built along the optimal route at a reasonable cost, the power of eminent domain—whose exercise is properly restricted to truly public uses and which must always be accompanied by "just compensation" paid to dispossessed owners—is worthwhile for government to possess.

That's the theory. And it's undeniably possible that some real-world situations might be accurately described by the theory. But it's unwise to base law and public policy on mere possibilities; a sounder basis is plausibility. For at least two reasons, it is implausible to suppose that government needs, or should be entrusted with, property-seizing power that no one in his right mind would entrust to private people.

The first reason is that private developers routinely assemble large contiguous tracts of land without relying on eminent-domain seizures. As I wrote recently (for *Regulation* magazine) in a review of Richard Epstein's brilliant book *Skepticism and Freedom*,

> America is planted thick with housing developments on large contiguous plots of land. Private developers manage to assemble those tracts without eminent domain. The Walt Disney Company purchased 30,000 contiguous acres of land in central Florida for its amusement park and resort. That is an area twice the size of Manhattan. With skillful contracting maneuvers—for example, buying each plot of land contingent upon the successful purchase of all other plots of land necessary to build the road or airport—a government intent on serving the public should be able to do its job without powers of eminent domain.

If experience shows that private developers assemble such plots of land without eminent domain, why must the state employ this power? One possible answer is that government officials are less creative than are private entrepreneurs, if only because such officials have less personal wealth at stake in trying creatively to meet land-acquisition challenges. But surely government officials' weakness on the creativity front is a questionable justification for giving them power to seize property from the private sector.

Political Freedom Imperiled

The second reason is that the power to seize property is both especially dangerous and especially tempting to those who possess this power. It's dangerous not only for the economic reasons reviewed above, but also because it puts political freedoms in jeopardy. A state that can seize people's homes can also seize publishers' presses and broadcasters' studios. And no one should be trusted with such power. Anyone possessing it is too easily tempted to abuse it.

But even if courts diligently prevent government from seizing property to stymie political dissent, the temptation to abuse eminent-domain power for mere money-grubbing reasons remains powerful—as the facts of the *Kelo* case make clear.

New London struck a devil's deal with private developers: the city promised to seize the homes of ordinary citizens and transfer these properties to developers, who in exchange promised to build businesses that generate increased tax revenues for the city government (and nice profits for the private developers).

For anyone who fancies that politicians deserve unique trust with the power to seize property, the *Kelo* facts themselves should be sobering, for the most straightforward reading of them is that politicians will abuse this power shamelessly. I read these facts as evidence that politician Bob is no more to be trusted with seizure powers than is private-citizen Bob. The fact that politician Bob is elected to office and that "Honorable" commonly is prefixed to his name does not render him less likely to abuse power.

Kelo itself is vivid evidence for the case that *no* one and *no* organization is to be trusted with the awesome power to seize private property.

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Protecting Property in a Post-*Kelo* World

BY STEVEN GREENHUT

Two years ago, when I began writing a book, people's eyes would glaze over when I told them the subject was eminent domain, the power of the government to take property by force on "just" compensation to the owner. Rarely could I mention the subject without having to explain it in detail, and incredulity was a typical response to the realization that government now takes property for private uses rather than for the public uses allowed by the Constitution.

What a difference a lousy U.S. Supreme Court decision makes.

Now state legislatures, city councils, and Congress are up in arms about the subject. It is a true water-cooler topic. Newspapers, which in the past typically ignored the "abuse" of eminent domain when they wrote glowing reports about "economic development," are touching on the troubling ramifications of *Kelo v. City of New London*, in which a 5–4 Court majority declared in June that the city may hand over unblighted private homes near the waterfront to a developer for high-end condos and other private uses. Opinion polls show that an overwhelming majority of Americans oppose the ruling.

The word *abuse* is in quotation marks above because eminent domain is abusive per se: it *compels* the sale of private property, and since the sale is forced, there can be no "just compensation" as required by the Takings Clause in the Fifth Amendment to the U.S. Constitution. In most discussions, "abuse" pertains exclusively to takings not for "public use," as the clause requires, but for any vague "public purpose" that might be carried out by the new private owners of the property.

The Court's decision, however wretched, contained an important blueprint for reform. The majority wrote: "We emphasize that nothing in our opinion precludes any state from placing further restrictions on its exercise of the takings power." And Americans are taking the Court at its word.

Already, one state—Alabama—has enacted a law prohibiting the use of eminent domain to increase tax revenue or for private development.

Already, one state—Alabama—has enacted a law prohibiting the use of eminent domain to increase tax revenue or for private development. Delaware has enacted a law that "requires eminent domain only be exercised for the purposes of a recognized public use." But the Washington, D.C.-based Institute for Justice (IJ), which argued *Kelo* before the Supreme Court, says that law essentially upholds the ruling. The institute reports that, as of August, 31 states have taken some kind of action, with 17 legislatures introducing bills, seven announcing plans to do so, and other states introducing constitutional amendments or setting up commissions to study ways to stop eminent domain from being used for private development.

Unfortunately, while citizens are reacting to the decision, so too are cities, which are taking *Kelo* as carte blanche for the most aggressive redevelopment plans.

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The *New York Times* on July 30 explained that "the ruling has emboldened some cities to take property for development plans on private land. . . . [I]n Santa Cruz [Calif.], for example city officials started legal action this month to seize a parcel of family-owned land that holds a restaurant with a high Zagat rating, two other businesses and a conspicuous hole in the ground and force a sale to a developer who plans to build 54 condominiums."

Members of Congress also have proposed some limited restrictions on eminent domain. As the *Environment and Energy Daily* reported on July 19, "The Congressional Western Caucus has formed a new task force meant to defend property rights in light of a controversial June Supreme Court decision on eminent domain, as members continue to propose legislation to lessen the effects of the ruling." The goal, according to the publication, is to create a united front in Congress, given that six bills have been proposed.

Members of Congress also have proposed some limited restrictions on eminent domain.

"Sen. John Cornyn, R-Texas, has introduced a . . . bill (S. 1313), which would clarify that the power of eminent domain should be available only for public use and specify that economic development does not count as a 'public use,' " according to the article. Also, the House voted 365 to 33 denouncing the decision, a resolution that has no teeth. However, the *Washington Post* reported that the House voted 231 to 189 to ban the use of eminent domain on projects that involve federal housing or transportation dollars.

The legal strategy will vary from state to state, given our federalist system and the fact that each state finds itself in a unique legal and statutory position with regard to eminent-domain uses for economic development.

In six states—Kansas, Connecticut, Maryland, Minnesota, New York, and North Dakota—the highest courts have already ruled in favor of cities in cases of eminent domain for private use. That means that residents of those states must live with the standard set up in *Kelo*—that is, basically anything goes.

Nine state supreme courts have addressed the issue and come down on the side of property owners. These are Arkansas, Florida, Illinois, Kentucky, Maine, Montana, South Carolina, Michigan, and Washington. But even in these states the situation is shaky for property owners. Many of the decisions are old, and some of the states have statutes that explicitly allow eminent domain for economic development, Dana Berliner, attorney for IJ, explains.

"The remaining 35 states are up in the air," Berliner said. "Most haven't looked at [eminent domain] in decades, and most haven't looked at it since the modern practice of taking property just for business development. So state supreme courts need to revisit this issue now."

Even the states with the best protections could use new laws or constitutional amendments banning the practice of eminent domain for private uses, she argues. In her report looking at such abuses from 1998 to 2002, Berliner found that eminent domain for private use had been carried out or threatened in 41 states, and she later found some other states to add to that list. That shows the degree to which this is a nationwide problem.

Poletown Decision Overturned

Last year the Michigan Supreme Court overturned the infamous 1981 Poletown decision. The original decision set the stage for the abuses evident in New London. The cities of Detroit and Hamtramck used their power of eminent domain on behalf of General Motors, which wanted to build a Cadillac assembly plant on the site of a 425-acre neighborhood—a thriving middle-class area filled with nicely kept homes, businesses, and churches.

The cities didn't argue that the neighborhood, named for the Polish immigrants who first settled the area, was blighted. Rather, officials argued that the economic fate of the depressed Detroit region was at stake if eminent domain wasn't used to help GM. The facility was built, though it never performed up to promises. The ruling was on the books 23 years until Michigan's high court revisited it in July 2004.

The Court described the original Poletown decision as a "radical departure from fundamental constitutional principles. . . . [I]f one's ownership of private property is

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forever subject to the government's determination that another private party would put one's land to better use, then the ownership of real property is perpetually threatened by the expansion plans of any large discount retailer, 'megastore,' or the like." That decision reads like Justice O'Connor's dissent in *Kelo*. Unfortunately, Michigan is the rare state where the court has spoken so clearly.

Several states don't go nearly as far as Michigan, but require that governments prove that blight exists before invoking eminent domain. That is the standard in California, but I've found it to be an ephemeral protection at best.

Following *Kelo* the California Redevelopment Association (CRA), in its overheated response to efforts to restrict eminent domain, argued that a proposed constitutional amendment "is a solution in search of a problem. California is not Connecticut." The CRA emphasizes that the blight requirement keeps cities from abusing the process.

Yet my reporting in Orange County and elsewhere has shown the degree to which this is a genuine problem desperately in need of a substantive solution, as city governments routinely declare nice neighborhoods blighted in order to clear them away and build tax-generating facilities.

IJ's Berliner echoes that view, pointing out that property owners who challenge a blight designation in California often win, but it is so costly and difficult to fight that challenges are rare. It's similar in other states with blight requirements.

"The statutory definition of blight in Illinois is broader than the Mississippi River at its mouth," said Illinois state Sen. Steve Rauschenberger, who recently sponsored legislation to ban eminent domain for private uses, according to the Associated Press.

Berliner, speaking before the Illinois Assembly, offered specific advice to protect property owners in Illinois. One idea gets to the heart of the blight-protection problem:

"Illinois needs to . . . remove from the various definitions of blight factors that are too vague or allow condemnation simply for what local planners think is a better use." Indeed, blight becomes whatever government officials want it to be. They have declared newer housing tracts, decent shopping centers, upscale buildings with chipping paint, and empty desert land as "blight." In Mammoth Lakes, California, a rural resort community in the Sierras, officials called the downtown blighted because of excessive urbanization—something so absurd that even the courts overturned that finding.

The California Model

In California two main reform efforts failed in the final days of the legislative session. Unsurprisingly, neither challenged eminent domain per se. The first, introduced by state Sen. Tom McClintock and Assemblyman Doug LaMalfa, proposed an amendment to the state constitution. Here's the key language: "Private property may be taken or damaged by eminent domain only for a stated public use and only upon an independent judicial determination on the evidence that no reasonable alternative exists. Property taken or damaged by eminent domain must be owned and occupied by the condemnor or may be leased only to entities regulated by the Public Utilities Commission. All such property must be used only for the stated public use."

The second, introduced by Assemblywoman Mimi Walters, offered a simple statutory improvement: "This bill would provide that 'public use' does not include the taking or damaging of property for private use, including, but not limited to, the condemnation of nonblighted property for private business development." If passed, the legislation would reinforce that the Connecticut standard does not apply in California, but it would not fix the abuse of the blight provisions by zealous California cities.

In addition to California, IJ reports that Texas and four other states are pursuing a constitutional amendment.

The Reason Public Policy Institute has offered sample state legislation. As Reason explains, the simplest method is to "delete the statutory authority for such uses of eminent domain. . . . [I]n 2004, Utah simply removed the authorization for eminent domain from its act giving powers to redevelopment authorities. . . . Three other types of provisions that also discourage the abuse of eminent domain are (1) allowing a former owner to regain ownership of condemned property if the government fails to use it within a given period of time; (2)

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time limits on blight or redevelopment designations; (3) attorneys fees for condemnees challenging the validity of takings." Reason also proposes possible language that specifically prohibits eminent domain for private business.

The final approach, described by Reason, would ban eminent domain for economic development, and includes a definition of such as "any activity to increase tax revenue, tax base, employment or general economic health."

Various state bills typically embody one of these forms. IJ's list of proposed state legislation includes Colorado, which would limit the ability of agencies to declare a property blighted; Massachusetts, which would ban eminent domain unless the property is blighted; Minnesota, which would forbid using eminent domain to transfer property to a "nongovernmental entity without the power of eminent domain"; and New Jersey, which would forbid eminent domain under redevelopment law.

Many states have several proposals circulating at once. The Connecticut legislature defeated one measure that would prohibit the taking of residential dwellings for use "in a municipal development project that will be privately owned or controlled." But the governor called on the legislature to issue a moratorium on eminent domain until the law is revised.

Even cities are getting in on the act. The city of Orange, California, voted to express opposition to the *Kelo* decision. Although such resolutions by city councils have no real weight, what does have weight is the understanding that council members will vote against eminent-domain actions. In California 90 percent of redevelopment agencies are run by the city councils and state law requires a supermajority of members to invoke eminent domain.

Most California city councils have five members. If every one of those councils had two members opposed to eminent domain for private use, these projects would always be stopped. Cities can also pass ordinances and change their charters to limit eminent-domain abuses. Those ordinances would have language similar to the language in Reason's model statutes.

The best response in California has come from Anaheim. Mayor Curt Pringle announced, immediately following the *Kelo* decision, that his city would never use eminent domain for private development. These words are backed up not only by an anti-eminent-domain council majority, but also by several years of taking an alternative approach that contradicts the conventional wisdom offered by redevelopment agencies. Anaheim has refused to use subsidies and eminent domain, preferring to expand free-market opportunities for redevelopment.

For instance, the city targeted an area that it perceives as the next downtown. It is an area comprising one-story warehouses near the baseball stadium and hockey arena. So the city council said to developers: Come bring us your plans for the area. Build what you want. The only thing we will do is change the zoning so virtually anything can be built there. Sure enough, there are fascinating development proposals for the site.

This, ultimately, is the alternative to the redevelopment mindset, and the antidote to wanton eminent domain.

Until cities across the country embrace the Anaheim model, or until states impose legislative reforms that at least restrict eminent domain, there is only one avenue left to citizens who face such abuses. They can organize.

In Garden Grove, California, I watched hundreds of residents turn out to oppose a plan that would have leveled their neighborhood through eminent domain to allow for a theme park. Council members heard their voices and decided to stop the plan. In Lakewood, Ohio, where the city wanted to clear lovely historic homes along a park to make way for new condos and shopping, residents stopped the plan through a referendum and eventually succeeded in recalling the mayor.

It would have been best had the Supreme Court stopped the abuse of American homeowners and the Constitution, but even with this bad decision Americans have many avenues to pursue. The best news is that a backlash is in full swing. The key now is to keep the movement going until residents of every state are protected in the way the nation's founders envisioned.

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The Effrontery of the "Open Space" Movement

BY P. GARDNER GOLDSMITH

New Hampshire is called the "Live Free or Die" state. It has garnered such a reputation as a bastion of freedom that the "Porcupine" members of the Free State Project selected it as the place to which they would like to relocate in order to live more independently and more productively.

Unfortunately, the very principles that have helped keep the New Hampshire government small, and that have helped keep its impact on the economy to a minimum relative to the states around it, have created a market environment that attracts migrants who do not understand or appreciate the philosophy that fosters such prosperity. Thus in a place that once reflected General John Stark's Revolution-era motto, "Live Free or Die," the population that has just swelled to over 1.3 million seems more interested in the idea of living off someone else than in living free.

As the "Porcupines" contemplate relocating to their chosen redoubt, they may want to consider this political reality, and study a case in point.

Last spring, towns and cities all across New Hampshire had on their ballots what are called "open space" initiatives. These ballot questions, infused with that peculiar Baby Boomer desire to make everything look like a photo from an L.L. Bean catalogue, asked citizens to support enormous bond issues, eventually to be paid off with tax money, with which to buy select properties. The purpose is to "protect" them from residential development.

> The ethical principle of seizing money from someone against his will, and the economic complications that arise from deciding for someone how best he should use his money, were not discussed.

As strange as it may seem, the ostensible rationale offered by the well-organized proponents of these initiatives was that they would actually *save* taxpayers money in the long run. How? By buying land and preventing residential development, the sages of "open space" would be stopping more families from moving to town. This would restrict the growth of the school system, which is the largest portion of any budget in any New Hampshire municipality, sometimes comprising nearly 80 percent of the overall tax burden. By preventing land from housing more children, the taxpayers are, theoretically, protected in the long run. In other words, we must promise tax money to issue government bonds in order to save citizens from being taxed even more for government services. Supposedly, the purchase of pristine tracts of New Hampshire woodland and fields would decrease the pressures placed on many residents who cannot afford their property taxes. Older people, who no longer have children in school, are often depicted as the most notable beneficiaries.

In 25 New Hampshire communities between 2004 and 2005, some $26 million in taxpayer money was promised in order to sell bonds with which to purchase "open space," all under the guise of "helping save" taxpayers' money. My town of Amherst is no exception.

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In a typical gathering organized in the basement of a local church, the members of our Open Space Advisory Committee—which, it was my masochistic pleasure to discover, had been appointed by our own town selectmen—presented their arguments for taking from me in order to protect me.

There were posters and fliers, a PowerPoint presentation, and numerous speakers, all selected for their unique ability to espouse the eventual seizure of $5.5 million for the purpose of taking land out of the hands of residential developers, thus keeping our taxes low.

Of course, the ethical principle of seizing money from someone against his will, and the economic complications that arise from deciding *for* someone how best he should use his money, were not discussed. What was stressed was the tax benefit of keeping "open space" free of residential development, with the added sentiment that government ownership of pristine lands would allow our town to retain its "rustic" flavor and visual beauty.

However, the proponents did not even have an economic argument with which to convince voters to support their initiative. A person inquisitive about the committee's claim might want to know how much money is, on average, paid into the tax system by a homeowner during the time his children are in school and after they are finished. This would give interested parties an idea of whether residential home development is a net gain or a net expense to the town. But when asked if anyone on the committee had an estimate regarding how long homeowners held on to their homes after their children left school, the head of the committee replied, "That would probably be a good thing to know."

Probably.

The proponents also seemed blissfully unaware of another important consideration. Their own PowerPoint presentation indicated that the use of land which is "least burdensome" to the government is commercial use. It brings in taxes, while demanding fewer "services" such as schools and recreation activities run by the government.

This was a point I thought deserved emphasizing, and so I brought it up. "Since," I explained (tongue in cheek), "your presentation shows that the most beneficial use of land for a town's tax purposes is to allow it to be developed commercially, and we are supposedly here to buy land in order to save taxpayers money, then why aren't we here discussing a $5.5 million bond to buy property and ensure that it is developed commercially?"

There were some blank faces, so I went on.

"The very fact that we *aren't* here discussing purchasing land for commercial development indicates that this meeting has nothing to do with trying to save the taxpayers money. The organizers cannot even support their claims that holding 'open space' really *would* decrease taxes, because they do not have enough data regarding how long people pay into the tax system after their children may have left the schools. This meeting is clearly not about saving tax money. It is about taxing our neighbors in order to keep land looking the way you want it to look; it is about taxing your neighbor to pay for something you think is pretty. And before you vote, you need to ask yourselves, would you really take your neighbor's money against his will in order to buy something you think is pretty?"

In an instant, I was greeted with sharp looks, and bold answers in the affirmative.

"Absolutely," said one man.

"Darn right," proclaimed another as he pursed his brow at me.

I left the meeting wondering what had happened to New Hampshire. Two weeks later, by a margin of 26 points, the supporters of the $5.5 million bond secured their victory, and the supposed protection of all our wallets.

Were We Too Ignorant?

It may seem odd, but I find it difficult to thank the "open space" proponents for their guidance in leading my life. Perhaps I, and others like me who opposed the initiative, were simply too ignorant to see the wisdom of increasing taxes now to keep taxes low in the future. Perhaps we just spend too much time thinking of other arbitrary government restrictions on property owners: things like zoning ordinances, building permits, and eminent domain must capture too much of our attention to allow us to contemplate this clearly beneficial move toward a brighter community future.

Of course, it could be that they were wrong, and we

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in the minority were right, but that's irrelevant as far as democracy is concerned, and the leftists do tell me America was founded as a democracy, not a constitutional republic.

New Hampshire used to be a place where individual rights were respected, where economic freedom walked hand in hand with political freedom. Today, it is turning into an egalitarian wonderland, where aging '60s survivors tell their neighbors they know better how to spend their neighbors' money, and where private attempts to preserve "open space" are forgone in favor of tax initiatives enacted for the "public good."

Frédéric Bastiat, the French political economist who spent much of his life opposing the socialistic bromides promulgated by his nineteenth-century countrymen, is famous for having garnered many keen insights into the workings of the state. Among his trenchant observations was one that still bothers many welfare statists, perhaps because it is so appallingly true.

"The state," he noted, "is that great fiction by which everyone seeks to live at the expense of everyone else."

Here is a message to the courageous members of the Free State Project: Welcome to your new home, where the motto used to be "Live Free or Die."

We are trying to figure out whether that phrase still applies.

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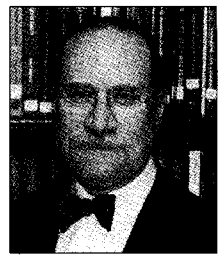
The Supreme Court and the End of Limited Government



BY SHELDON RICHMAN

The Supreme Court ruling permitting governments forcibly to transfer property through eminent domain from one private party to another for the sake of economic development did not come out of the blue. Although the Takings Clause in the Fifth Amendment to the U.S. Constitution specifies "nor shall private property be taken for public use without just compensation," the "Court long ago rejected any literal requirement that condemned property be put into use for the general public" (*Hawaii Housing Authority v. Midkiff*, 1984, cited in the current case, *Kelo v. City of New London*).

In 1954 the Court unanimously upheld Washington, D.C.'s taking of a department store as part of a plan to replace a blighted neighborhood, although some of the land would be turned over to private parties (*Berman v. Parker*).

In 1984 the Court upheld a Hawaii statute that sold tenants their apartments against the will of the owner (*Midkiff*). The objective of the statute was to diffuse the ownership of land, and the Court deferred to the legislature's belief that this was a proper public objective. What counted, the Court wrote, is "the taking's purpose, and not its mechanics." Other cases could be cited.

In the current case Justice John Paul Stevens, writing for the 5–4 majority, invoked deference to the people's representatives in explaining why the taking of homes and businesses in New London, Connecticut, for economic development is something the court should countenance. "Because that [development] plan unquestionably serves a public purpose, the takings challenged here satisfy the public use requirement of the Fifth Amendment." In other words, public use includes any valid "public purpose," and legislative bodies have wide latitude in acting on behalf of the public. It is of no consequence that a private party will benefit in the process. "Quite simply," Stevens writes, "the government's pursuit of a public purpose will often benefit individual private parties."

In a concurring opinion Justice Anthony Kennedy opined against the petitioners' plea for a rule making economic-development takings *per se* or at least presumptively invalid. "A broad *per se* rule or a strong presumption of invalidity, furthermore, would prohibit a large number of government takings that have the purpose and expected effect of conferring substantial benefits on the public at large and so do not offend the Public Use Clause."

> It is to Justice Clarence Thomas we must turn for a model of proper constitutional interpretation and reasoning.

That the majority followed the Court's precedent hardly makes the decision easier to swallow. Today it is clearer than ever that government can take property and transfer it to private individuals so long as it claims that its overriding purpose is the betterment of the public. The only limit set out by the Court is that the taking not be *solely* for private benefit. But that is no real limit at all. There is a word for a system in which private owners are *permitted* to retain their property *so long as they use it for the public good—as understood by the political authorities.*

This is scary. As Justice Sandra Day O'Connor writes in her dissenting opinion, "For who among us can say she already makes the most productive or attractive possible use of her property? The specter of condemnation hangs over all property." Then she adds perceptively, "[T]he fallout from this decision will not be random. The beneficiaries are likely to be those citizens with disproportionate influence and power in the political

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process, including large corporations and development firms. As for the victims, the government now has license to transfer property from those with fewer resources to those with more. The Founders cannot have intended this perverse result."

O'Connor's words are to be savored, although she largely accepts the precedents, striving only to distinguish them from the current case. But it is to Justice Clarence Thomas we must turn for a model of proper constitutional interpretation and reasoning. His dissenting opinion goes further than O'Connor's by calling the precedents into question. It is refreshing indeed.

Thomas writes: "Today's decision is simply the latest in a string of our cases construing the Public Use Clause to be a virtual nullity, *without the slightest nod to its original meaning*. In my view, the Public Use Clause, *originally understood*, is a meaningful limit on the government's eminent domain power. *Our cases have strayed from the Clause's original meaning, and I would reconsider them.*" (Emphasis added.)

Thomas proceeds to show, first, that it is sound constitutional principle to regard every word in the Constitution as meaningful and purposeful; second, that *use* at the time of the framing meant the "act of employing"; third, that to construe *use* more broadly would make the Takings Clause duplicative of powers already expressly delegated; and fourth, that the common law and great legal authorities such as Blackstone support this narrow reading of the word.

Thus, "The Constitution's text, in short, suggests that the Takings Clause authorizes the taking of property only if the public has a right to employ it, not if the public realizes any conceivable benefit from the taking. . . . The Takings Clause is a prohibition, not a grant of power. . . . The Clause is thus most naturally read to concern whether the property is used by the public or the government, not whether the purpose of the taking is legitimately public."

Since that is the case, the issue of deference to the legislature is put into perspective: "[I]t is most implausible that the Framers intended to defer to legislatures as to what satisfies the Public Use Clause, uniquely among all the express provisions of the Bill of Rights."

He concludes: "When faced with a clash of constitutional principle and a line of unreasoned cases wholly divorced from the text, history, and structure of our founding document, we should not hesitate to resolve the tension in favor of the *Constitution's original meaning*." (Emphasis added.)

It should go without saying that even the most narrowly construed eminent-domain power would violate individual rights. Either a person owns his legitimately acquired property or he does not.

The Court Has Spoken

Dissenting opinions are, alas, just that. As things stand, the majority rules. Governments may take private property and give it to anyone they like; all they must do is proclaim that this serves a public purpose. How in principle can one show otherwise? The Court has spoken: it will not second-guess such decrees.

A final note: It should go without saying that even the most narrowly construed eminent-domain power would violate individual rights. That taken property is to be literally used by members of the public or by the government itself provides no valid justification for the taking. Either a person owns his legitimately acquired property or he does not. The requirement of "just compensation" cannot turn theft into something else. There is no just compensation possible in a forced sale. What makes a transaction legitimate is not compensation but *consent*.

That said, the framers at least sought to limit the government's eminent-domain power. On June 23 the Supreme Court erased the final traces of that limit.

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The Tyranny of Local Government

BY PAUL MESSINO

Thanks to the recent decision rendered by the Supreme Court in *Kelo v. City of New London,* citizens across the nation have a new reason to fear government. The decision affirms that the seizure of private property by the government in the name of economic development is consistent with the Takings Clause of the Fifth Amendment. This alone does not destroy the property rights of every landholding individual. But it does give states the power to move in that direction.

In reaction to the rising fear among citizens, a few states have either reiterated or redefined their laws in favor of private property. While this is comforting for the moment, chances are that with the big nod from the Supreme Court, local governments will be moving in on private property once the carrot of tax-base expansion becomes too appealing to ignore.

And why wouldn't this be the case? Local governments have been razing property rights in the name of public interest for years. Just look at the process of annexation and incorporation, a local-government phenomenon that can be particularly invasive.

Let's take, for instance, my home state, North Carolina. While many states have towns and cities with contiguous borders inside county lines, North Carolina has what amounts to "islands" of towns and cities, sometimes separated by miles of rural landscape. Residents who live outside these "islands" are residents of the county only. These areas are "unincorporated."

An unincorporated area might be annexed by a town or city. This is a state legislative process that ends with the addition of both new land and residents to an already established town or city. An unincorporated area can also incorporate. After successfully completing legislative qualifications, residents in a certain area can then form a town or village. The incorporated area must then provide a number of services to all inhabitants. Annexation or incorporation can and often does occur without the consent of the affected property owners.

Local governments have been razing property rights in the name of public interest for years. Just look to the process of annexation and incorporation.

Consistent with *Kelo*, sometimes annexation or incorporation is used to "increase the wealth" of an area. Cities and towns eager to extend their tax base open their civic maw to neighbors on the fringe while promising improved services, which in most cases never increase a citizen's standard of living.

But at other times, local governments use either annexation or incorporation to stop progress. Local governments can usurp land, fence out undesirables, and restrict growth patterns as they see fit, all within the boundaries of the law. The destruction of individual freedom that has become commonplace in local arenas leaves many on the losing side lamenting the moral atrophy of civil law.

This is just such a story. It is set in a small community in North Carolina, where the power of incorporation was used to stop economic growth and destroy a man's property rights in the process.

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Our story begins in the unincorporated area of Misenheimer, originally home to a nineteenth-century resident, Tobias Barringer. According to various newspaper accounts at the time, Barringer purchased his property sometime in 1824. This simple plantation, small by Southern standards, housed a few slaves and yielded a modest crop. One day while hunting on the property, Barringer noticed golden metallic flecks shimmering in a stream. Digging into the adjacent stream bank, he struck gold. Little did he know, but he had struck it big—one of the largest veins of gold in North Carolina history.

Richard F. Knapp of the state Department of Cultural Resources, coauthor of *Gold Mining in North Carolina*, described the discovery of the Barringer Gold Mine as a "watershed event in U.S. gold mining, moving the industry into the age of vein mining."

The fortune of the mine, however, turned tragic in 1904. Under the ownership of the Whitney Mining Company, eight men were killed when a heavy deluge hit the county on August 11 and flooded the mine. After the tragedy (and the ensuing lawsuits) the mine closed.

On March 25, 1998, Stanly County developer and entrepreneur Joe Carter bought the mine and nearly 240 acres of land. While clearing the land for development, the revenues from which were to go to the creation of a Christian school, Carter, much like Barringer, discovered gold. The discovery led Carter to hire the services of numerous experts who were to assess the viability of mining.

The experts concluded that the mine offered many valuable possibilities for Carter. Not only could this small portion of the land be used for excavating gravel and sand for highway construction, but the mine contained a thin, and in some places extremely pure, vein of gold. In their estimation, only 10 percent of the total gold had been removed.

Carter, along with additional investors, acquired both federal and state mining permits for his newly created company, Barringer Mines, LLC. However, when presenting his intentions to the Planning Board of Stanly County, Carter was denied the right to mine. Residents feared the dust and noise pollution would harm their way of life. Carter was denied permission to proceed not once but twice by the Planning Board—comprised of a handful of individuals with no background in mining.

Initially, Carter wanted to rezone all 240 acres of his land for mining; but because he realized that some neighbors and the planning board and staff were worried about his intentions, he continually reduced his request for rezoned acreage. At the advice of the planning board, Carter settled for the rezoning of only 50 acres.

Split Decision

In a final attempt, Carter was able to get a split decision to rezone his property from Residential Agricultural (RA) to Heavy Industrial (M2) with a conditional-use permit. That final split decision led to a public hearing before the county commission on April 8, 2002. Carter and his consultants illustrated their intent to create multiple new businesses and dozens of jobs while staying within the state and federal guidelines for mining.

> Rhetoric and fear-mongering pervaded the opposition.

During the hearing, he and his supporters ran into opposition headed by local resident Peter Edquist and David Ambrose, president of nearby Pfeiffer University. The university, once a Methodist-affiliated college, is attended by some 600 students, four times the number of permanent residents in the area.

Numerous residents, many of them students, testified that they were worried about the effects of the mining process on their daily lives—a legitimate concern. But alarmist rhetoric and fear-mongering pervaded the opposition. Some feared that Carter's real goal was to start a rock quarry, that the gold and tourism plans were just a ruse, and that the actual intent was to quarry aggregate for construction, even though the aggregate being removed for highway use was a byproduct of the mining process.

Carter's side countered fear with fact. Concerned that citizens might not understand the lengths to which he was willing to go to placate their fears, Carter paid to bring in experts from across the nation to testify to the safety and importance of the mine.

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Stuart Brashear, a blast expert with Dyna-Nobel, a leading manufacturer and distributor of explosives and their components, told the hearing that neither dust levels nor blast sounds or vibrations would exceed state or federal restrictions. In fact, he said, that due to the use of a "wet mining process," dust should not be an issue.

Paul Harrison of the Moser Group, Inc., a brokerage and development firm that does commercial appraisals and consulting for the state, was hired by Carter to assess the impact on land values for properties adjacent to a mine similar to the proposed Barringer operation. Harrison concluded that the impact was negligible. But this wasn't enough.

State Sen. Fletcher Hartsell, hired by Pfeiffer University as counsel through his private law firm, said that there was no guarantee that Carter would use his land only to mine. Hartsell could not refute the studies presented by Carter, so he used scare tactics centered on what-ifs. Because M2 includes other uses such as junk-yards and chemical waste sites, Hartsell argued that the M2 zoning would not be harmonious with the county.

The fear-mongering by the political elite worked. Residents voiced their concerns. Astoundingly, one citizen said he opposed the mine because he feared the dust from the crushed rocks would cause cancer. Another resident said that if the mine were allowed, the town would forever be in the shadow of heavy industry.

University President Ambrose testified about the beginning of Carter's endeavor, saying they had had positive discussions about the original residential development. It was only after learning about the mine that he began to have "serious concerns" and helped organize citizen and student opposition.

Fear Prevails

The collective voice, stirred by little more than fear, won out. County commissioners voted against the rezoning unanimously, ruling, in effect, that it was in the county's best interest to overlook the billions literally beneath its feet. But Carter wasn't finished.

During the late summer of 2002, the adjacent town of Richfield worked with Carter on an annexation strategy that would have allowed for operation of the mine. Richfield was eager to have the mine within its boundaries, recognizing the environmental soundness of the operation as well as the economic benefits.

Concurrently, both Ambrose and Edquist went on offense. They used their influence to lobby support from alumni, students, and residents, and the legal representation of Hartsell, to take a different approach. County government only has so much power. If Carter could have his land annexed by an adjacent town, he could still mine in the "backyards" of Misenheimer naysayers. But opponents of the mine could block this by petitioning the state to create a new town. Under state law, they could forcibly annex Carter's property and neutralize any rights he and his business partners had to develop the Barringer mine for anything other than homes and farms. This is exactly what occurred.

According to its advocates, the proposed village of Misenheimer was to comprise a handful of small lots, some churches, and two large tracts. Carter's 240 acres would be the largest private tract. The rationale for including Carter's land, Ambrose said, was that projected sewer-line expansions were to occur there. But Stanly County officials said that sewer lines do not run into the Misenheimer area and no such move is projected. No matter: Carter's land was included in the new village, setting him up for sabotage.

Pfeiffer University, the other large tract and exempt from property taxes, would use its police force to serve the entire village. State law stipulates that an incorporated area must provide four of eight specified services, one of which is police protection. The university would pay $350,000 for the force, which the village could not otherwise afford. Pfeiffer's decision to pay for police not only provided indispensable help, but also elevated its power, prestige, and influence in the eyes of the proposed village's residents.

On February 17, 2003, State Sen. Bill Purcell filed Senate Bill 76 for the incorporation of the village of Misenheimer. It had the support of the Stanly County Commission. According to documents submitted to the General Assembly of North Carolina, supporters of the village claimed that of the 183 registered voters in the area, 154 of them supported incorporation. For an area to be considered for incorporation, 15 percent of registered voters there must sign a petition stating their

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assent. However, when asked to supply the petition, no government official associated with the process had a copy of the signatures. There appears to be no way of verifying what the final total actually was or who the signatories were. Based on the numbers supplied by the Board of Elections, 17 percent of the voting population could be Pfeiffer students. With no way to verify the petition, Pfeiffer students, who have no long-term commitment to the area, could have been a deciding factor in the outcome of incorporation.

Before the General Assembly voted on the bill, Carter tried to bring witnesses to a legislative committee meeting, but was told the schedule had been changed. Unbeknown to him, the committee met and voted on incorporation days later.

The legislation was ratified by the General Assembly on June 26, 2003. Hartsell, who had represented Pfeiffer and Edquist, voted aye.

Carter, stripped of his property rights but nevertheless the largest landholder and taxpayer in Misenheimer, cannot develop his tract unless the village council, appointed by the legislature, approves. Ambrose was on the council, but has since moved from Misenheimer. Edquist serves as mayor until this month's municipal elections.

Bound to forced incorporation, Carter has only three options. He can sell his land, but because of zoning restrictions, the property might sell for hundreds of millions of dollars less than in a free market. He can wait until a majority of sympathetic citizens are voted onto the council, but given the influence of Pfeiffer University and its willingness to use local-government power to abridge the property rights of its neighbors, this is not likely to happen soon. Or he can wait and hope that the village falls into financial ruin, emaciated by a low tax base depleted of any viable economy, and is de-incorporated.

It's a shame that the structure of government allows for the legal degradation of property rights. Carter, who played by the rules, supplied voluminous evidence, and promised to bring jobs and prosperity to the community through an influx of wealth, was denied the opportunity to use his land to its utmost potential. Thanks to the ability of a few powerful citizens who skillfully disguised fear as truth, a law biased against property rights, and the inconspicuous dealings of local government, Carter's rights have been reduced by the desires of a few.

Like the *Kelo* case, this story makes it abundantly clear that private property is at the mercy of government.

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Why Classical Liberals Care about the Rule of Law (And Hardly Anyone Else Does)

BY ANDREW P. MORRISS

In 1776 John Adams declared that America was "a nation of laws, not men." Politicians of all persuasions have used Adams's phrase ever since to claim the moral high ground. Such rare agreement among the political classes, even if only rhetorical, is an indication of the power of the idea of the rule of law.

What does it mean to have the rule of law? Adams's opposition of "a nation of laws" to one of "men" suggests part of the answer. A "nation of men" would be one governed by the desires and whims of the rulers, unconstrained in their impositions on those they ruled. Disputes would be decided according to the rulers' preferences, not principle, leaving individuals dependent on having a protector among the rulers. A "nation of laws," on the other hand, would substitute principle for preference.

Consider a simple question of whether John must repay a loan from Mary. In a "nation of men," the fact of the loan would be irrelevant; what would matter was whether John's patron outranked Mary's. In a "nation of laws," on the other hand, if Mary could establish that John had borrowed money from her and not repaid it, the principles of contract law would require John to repay the loan regardless of whether John had more powerful friends than Mary.

In other words, societies without the rule of law would be Hobbesian states of nature, with escape possible only through the intervention of the Leviathan. That escape would be purchased with the surrender of liberty to the Leviathan and the acceptance of his exactions as the price of preventing the greater losses of the war of all against all. In the society with the rule of law, on the other hand, individuals would not fear their neighbors, since disputes would be settled through the application of principles known in advance. These individuals would have no reason to submit to the local Leviathan. (What we know about a variety of "primitive" societies suggests that the rule of law was far more common than was once believed. Bruce Benson's *The Enterprise of Law*, for example, documents the widespread existence of the rule of law in a variety of pre-modern societies.)

Societies without the rule of law would be Hobbesian states of nature, with escape possible only through the intervention of the Leviathan.

In a society governed by the rule of law, we should expect to observe two key features. First, the principles by which disputes will be resolved are known in advance. John knows before he borrows the money from Mary that promises to repay loans are enforceable. Second, the result of the application of those principles to a dispute does not depend on who the parties are. Powerful people are governed by the same rules as the weak, the rich by the same rules as the poor.

These are necessary but not sufficient conditions for the rule of law. While we sometimes take these components of the rule of law for granted today, they have often

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been absent under tyrannical rulers. For example, the Roman Emperor Caligula had imperial decrees written in small letters and posted so high up on pillars that the decrees could not be read, ensuring that citizens could not know whether or not they had violated the law.

These conditions are enough to exclude arbitrary tyranny like Caligula's, but not enough to get us to a free society. We need to constrain the content of laws for two reasons. First, for there to be the rule of law, both John and Mary must be secure enough in their property rights to have accumulated sufficient assets to make their transaction possible. Second, we need to be able to eliminate orderly tyrannies such as fascism and communism, which oppress people with laws adopted in accordance with "proper procedures," as well as merely arbitrary ones such as Caligula's.

The German Nazi regime, for example, had many well-known, well-understood, and equally applied rules. The infamous Nuremberg laws, for example, outlawed marriages between "citizens of German or some related blood" and Jews. The law was known and understood by the public, and applied equally. As in most dictatorships, of course, enforcement of the law was sometimes arbitrarily waived—but our primary objection to the Nazi regime as violating the rule of law cannot be that its hideous laws were imperfectly enforced. Some restraint on substance of what lawmakers can do seems necessary.

Of course, the Nuremberg laws were built on the distinction between those of "German or some related blood" and Jews, a distinction we today recognize as having no validity whatsoever. Germany is not unique in having introduced such distinctions: much turned on minute distinctions of the degree of "African blood" under pre-Civil War and segregationist American laws, and similar nonsense continues today, from the United States (over "native Hawaiian" and American Indian status) to New Zealand (over Maori status). It is also present in nonracial distinctions—employment-discrimination laws treat people differently depending on whether they are large or small employers, employers or employees, or disabled or able-bodied, to name but a few such distinctions. Indeed, one of the fundamental problems in today's legal system is that our rights often depend on how the law categorizes us, an issue to which we will return below. The problem of treating individuals differently is thus not merely a relic of past tyrannies but a real problem in today's legal system.

Constraining the content of rules requires that we constrain the power of the bodies that create them.

Constraining Content

Constraining the content of rules requires that we constrain the power of the bodies that create them. Any reasonable theory of the rule of law ought to be able to distinguish the Nazi legal system from the legal system of a free society. Indeed, this seems like a minimal requirement. There are lots of closer cases where we want our theory to do much harder work in drawing distinctions. We thus need to add some kind of substantive constraint to our initial set of conditions. This is where things get tricky.

The notion that the rule of law requires a constraint on the reach of lawmaking powers is far from universally accepted. For example, Hans Kelsen, one of the twentieth century's major legal theorists, does not accept it. Kelsen (who was forced to flee Germany when Hitler came to power) thought the Nazi racial laws met the definition of law precisely because he defined law in terms of the ability of a state to back a command with the threat of force and did not impose substantive constraints on the content of the law. His theories are still taught throughout the world, particularly in civil-law countries, and he numbers among the fans of his jurisprudential theory Judge Richard Posner, one of the most influential figures in American law today. (Fortunately, given his position, Posner's own jurisprudence is considerably better than Kelsen's.)

We also have the problem of where to find the constraints we will impose. In his book *A Brief History of Time,* Stephen Hawking relates an anecdote of a scientist who, after delivering a lecture on the structure of the solar system and galaxy, was approached by a little old lady. She told him that his talk was rubbish because everyone knows that the earth is a flat plate balanced on

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the back of a giant turtle. The scientist responded by asking her what the turtle stands on. She replied, "You're very clever, young man, very clever. But it's turtles all the way down." Unfortunately many attempts to locate substantive constraints on the legal system devolve into resting our premises on ever-increasing numbers of turtles.

As F.A. Hayek perceptively noted in 1973, the problem is the legal system's refusal "to recognize as binding any rules of conduct whose justification had not been rationally demonstrated or 'made clear and demonstrative to every individual,' " a problem that has been an "ever recurring theme" since the nineteenth century (*Law, Legislation and Liberty*, vol. 1, p. 25; subsequent page numbers are from this book). Just as central economic planning intruded on the spontaneous order of the marketplace throughout the twentieth century, central legal planning displaced ever more of the spontaneous order of the common law. As a result it is turtles all the way down for most modern legal theorists. As they seek to impose their ever-more complex, planned, rational legal orders on society, they stack turtle on turtle in trying to locate a plausible source for the legislation they write.

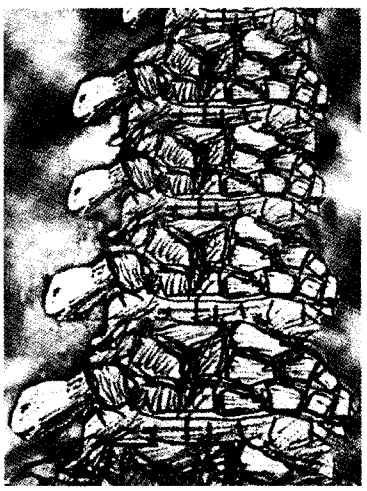

Illustration by Ron Henry

External Sources of Constraints

One possible source for substantive constraints is to look outside the legal system for a set of principles to guide the law. There are an infinite variety of possible sources: feminism, Marxism, fascism, divine law, or whatever ideology is the current favorite. All of these suffer from the turtle problem, of course, since we've simply substituted the problem of justifying feminism, Marxism, and so on for the problem of justifying the constraints on the legal system. Adherents to these various worldviews recognize the fundamental truth of their particular views, but convincing the rest of us has generally come down to using state power to coerce compliance. Of course, the next turtle down is the problem of how to resolve conflicts over which theory to use. For those who identify law only as the command of the sovereign, this is not a problem. The ism with the most guns gets to tell the rest of us what to do, and we should just be thankful if it doesn't turn out to be the Khmer Rouge or the Taliban running the show. This is not to suggest that my religious or philosophical beliefs shouldn't play a major role in shaping my conduct, just as yours do in shaping your conduct. The issue is whether my beliefs get to play a role in shaping yours and vice versa.

The records of societies that looked outside the legal order to religious, political, or other moral codes as the source of legal constraints are neither libertarian nor particularly happy ones. The Soviet Union, Puritan Massachusetts, and the Taliban regime in Afghanistan are just a few of the failed societies that relied on an external set of beliefs as the source of rules in the legal system. Unfortunately, they are also societies more famous for witch trials (political as well as religious) or mass killings than for flourishing economies or freedom. The lesson is that if we are to have a society in which people are free to hold diverse opinions about religious and ethical issues, we cannot rely on such sources to constrain power without igniting conflict over which religion or ethical system on which to rely.

Another possible source of constraints is to limit the subjects about which laws can be written. Disputes over the morality of consensual behavior between adults, for example, can be left to the pulpit and water cooler if the state is not authorized to legislate about such matters. The U.S. Constitution takes this approach by carefully enumerating the subjects over which the national government has authority. Through such limits, the Framers hoped to constrain the national government to a relatively narrow sphere.

Unfortunately, however, this strategy proved insufficient to permanently prevent the expansion of government power. Once the federal government was in place, it became a permanent lobby for enhancing its own powers and over time, bit by bit, many of the constraints imposed by the Constitution were worn away. For example, the Supreme Court allowed a steady expansion of congressional power under the Constitution's Commerce Clause (Article I, section 8, clause 3), ultimately

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holding in a 1942 opinion (*Wickard v. Filburn*) that Congress could rely on its interstate commerce power to punish a wheat farmer for growing wheat on his own land for his own consumption. (Sadly, the Court again endorsed this approach this year in *Gonzales v. Raich*, upholding federal rules barring the medical use of marijuana.)

Although more recently the Court has attempted to revive the notion of enumerated powers as a meaningful constraint on the federal government, the extent of its powers today would surely shock even the most ardent proponents of a strong national government among the Founders. While imposing as many constraints on state power as possible through a written constitution is worthwhile, what must be recognized is that such constraints are vulnerable to erosion from the ever-present pressures from governments and interest groups.

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Hayek's Solution

Where, then, can we find a source of limits that will constrain state power and enable us to live under the rule of law rather than men? Hayek wrote extensively about law, applying the insights of Austrian economics to the study of legal institutions in *The Constitution of Liberty* (1960) and a three-volume work, *Law, Legislation and Liberty* (1973, 1976, and 1979, respectively). Although there are certainly ambiguities and inconsistencies in his analysis, Hayek provided at least a partial solution to the problem of securing the rule of law, neatly addressing how to permanently constrain the domain of law-making and locating a mutually acceptable source of the constraint.

Central to Hayek's theory of law is the distinction between law and legislation: law is a spontaneous order that came largely from custom; legislation is a planned order created by human institutions such as legislatures. The distinction seems at odds with common usage. We often talk of "laws" passed by Congress and state legislatures. Few modern statutes would meet Hayek's definition of law, however. (Hayek did recognize the need for organizational statutes to structure the state, and transaction-cost-reducing measures that offered focal points such as clear rules on the formalities necessary to conclude a binding contract.) By introducing this distinction, Hayek pointed us toward a solution to the problem of constraining legislative power. Because it comes from custom and is the result of a decentralized process of dispute resolution, Hayekian law is not vulnerable to the interest-group pressures that bias the legislative process. (Hayek did not entirely exclude the legislature from contributing to the production of law. He allowed for intervention to save the legal system from conceptual "dead ends" (p. 100), although he never fully specified how one can distinguish a solution to a "dead end" from special-interest legislation.)

In a Hayekian legal order the judge "serves, or tries to maintain and improve, a going order which nobody has designed, an order that has formed itself without the knowledge and often against the will of authority, that extends beyond the range of deliberate organization on the part of anybody, and that is not based on the individuals doing anybody's will, but on their expectations becoming mutually adjusted." (pp. 18–19) Crucially, "[t]he question for the judge here can never be whether the action in fact taken was expedient from some higher point of view, or served a particular result desired by authority, but only whether the conduct under dispute conformed to recognized rules" (p. 87). As a result of limiting the production of law to the outcome of dispute resolution, a Hayekian legal order's rules focus on making "it possible at each moment to ascertain the boundary of the protected domain of each. . . ." (p. 107)

Legal rules, Hayek argued, must satisfy a principle of generality; that is, they must be general, non-arbitrary, and applied equally to all. Legal rules produced by common-law courts and ultimately rooted in custom meet these criteria; most of the product of legislatures does

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not. Hayek's generality principle solves the problem of constraint without resting on a turtle. We avoid the problem of treating the Nazis' Nuremberg laws as valid because a law that distinguishes between those of "German or related blood" and Jews violates the requirement of generality by introducing a distinction. We avoid the problem of special-interest legislation in the same fashion: special interests can't be "special" if they cannot distinguish themselves from everyone else. As a result, they cannot confiscate our assets for their benefit.

What kinds of laws pass Hayek's test of generality? Rules that allow individuals to make and keep private agreements, resolve conflicts, and structure their dealings meet the test. The essentials of property, tort, and contract pass unscathed.

What kinds of laws fail? Not much of the modern administrative welfare state would survive. Among the casualties:

- Environmental laws that prescribe differential treatment for different interests (such as the distinction between point and nonpoint sources under the Clean Water Act, which leads those who emit the exact same amount of the exact same pollutant from a field treated with fertilizers and from a factory to be treated radically differently).
- Employment laws that treat different groups of employees and employers differently.
- Regulatory laws that limit individuals' freedom to enter occupations.

Indeed, all the many statutes that take the property rights of one person and indirectly award them to another (so-called regulatory takings) would fail Hayek's test. (Hayek introduced some ambiguity on this point in volume three of *Law, Legislation and Liberty,* by suggesting there might be exceptions to the principles set out in the book for employment, environmental protection, and a surprising number of other areas. This is one of the rare occasions when I feel comfortable saying he was simply wrong.)

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Why We Need the Rule of Law (and Not Much Else)

This would not leave us helpless, however. As Richard Epstein has eloquently written, simple rules turn out to be remarkably robust for resolving the problems of a complex world (*Simple Rules for a Complex World*, 1997). The principles of tort, property, and contract are enough to enable market forces to produce solutions to problems that bedevil regulators trying to write comprehensive regulations, while avoiding the special-interest problems inherent in government action. Indeed, this relatively small set of laws is all we need for the same reason that we do not need state assistance in making markets "work." In fact, Hayek's legal theory is rooted in his economics, particularly his understanding of the critical role dispersed knowledge plays.

Just as Hayek showed in his 1945 essay, "The Use of Knowledge in Society," that attempts to "fix" specific problems in the marketplace by bureaucratically altering prices damage the market's ability to reconcile the diverse needs and resources of the millions of individuals, so too does he explain how attempts to "fix" legal problems through special-interest legislation damage the legal system's ability to provide law. Once courts move beyond enforcing the expectations of the parties in an attempt to produce specific distributional outcomes, the legal system's ability to reconcile the actions of individuals pursuing their diverse aims is damaged. No longer able to rely on the enforcement of their voluntary arrangements, people turn to Leviathan for protection, competing for recognition of their status as "deserving" and the special treatment such status brings. The result is a never-ending cycle of special-interest lobbying, bringing ever-increasing numbers of laws doling out favored status to clients of the powerful.

We can see this dynamic illustrated in the ever-increasing list of protected classes in employment law. The list of prohibited bases for employment decisions has expanded in some American jurisdictions to include

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sexual orientation, appearance, weight, and use of tobacco. With such an extensive list of prohibited bases for discrimination, of course, employers can no longer simply hire and fire employees. To avoid lawsuits, employers must invest in expensive compliance programs and vet their advertisements to avoid the appearance of impropriety.

Why No One Else Cares

Are classical liberals alone in caring about the rule of law? Increasingly it appears so. A nominally conservative administration in Washington seems more intent on outcomes than principle, abandoning federalism whenever it sees an opportunity to impose a desired outcome nationally. Some special-interest legislation is to be expected from any politician as the price of politics (the 2002 steel tariffs were a particularly clear example of such a measure), but the widespread abandonment of principle in areas as diverse as environmental regulation and tort "reform" makes clear the lack of commitment to the rule of law. At the same time, a nominally liberal opposition articulates its challenges to judicial nominees not in terms of their qualifications but based on whether they are "in the mainstream" of political discourse—in other words, whether the nominees will take the "correct" political position while on the bench.

Supreme Court Justice Antonin Scalia recently noted that the bitter fights over judicial confirmations are a sign that the courts are no longer about interpreting legal texts but about political decision-making.

> If we are selecting lawyers, if we are selecting people to read a text and give it the fair meaning it had when it was adopted, yes, the most important thing to do is to get a good lawyer. If on the other hand, we're picking people to draw out of their own conscience and experience a new constitution with all sorts of new values to govern our society, then we should not look principally for good lawyers. We should look principally for people who agree with us, the majority. . . . And that is why you hear in the discourse on this subject, people talking about moderate, we want moderate judges. What is a moderate interpretation of the text? Halfway between what it really means and what you'd like it to mean? There is no such thing as a moderate interpretation of the text. Would you ask a lawyer, "Draw me a moderate contract?" The only way the word has any meaning is if you are looking for someone to write a law, to write a constitution, rather than to interpret one.

Politics has captured the American legal system, an inevitable consequence of the judicial activism that flowed from the New Deal-era capitulation of the courts to legislative and executive power. As a result, interest groups from business lobbies to "public interest" groups see the courts as simply one more battlefield on which to seek special treatment. Many profit from this state of affairs—lawyers, lobbyists, regulators, and the interest groups themselves. They are not interested in ceding this profitable arena by acquiescing in the reinstitution of the rule of law.

All is not lost, however. Old constraints have revived. Richard Epstein's book *Takings* (1989) launched a revival of the federal takings doctrine that promises to yield some limits to special-interest legislation. (The current Supreme Court's determination not to follow Epstein's analysis through to its logical conclusions is limiting the impact *Takings* ought to have. Unfortunately the decision in *Kelo v. City of New London* is only the most recent example of this.) Last year the Michigan Supreme Court reversed its pernicious Poletown decision and reinvigorated its state constitutional takings jurisprudence (*County of Wayne v. Hathcock*). Restoring the rule of law will be a long hard road, but articulating the benefits can help create the atmosphere in which it is possible. Ideas matter—and on this issue classical liberals have the better idea.

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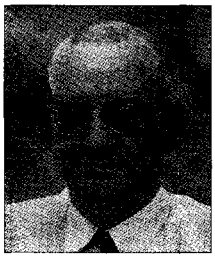

Warriors and Merchants

BY STEPHEN DAVIES

In 1915 the well-known German economic historian Werner Sombart published a book with the arresting title *Merchants and Heroes*. It argued that the war then underway between the Central Powers and the Entente was not just a traditional great-power conflict. It was rather a struggle between two different worldviews embodied by France and Britain on the one side and Imperial Germany on the other. One was that of the merchant, the world of trade, money, exchange, and bourgeois comfort and respectability. The other was that of the warrior, the world of the stern, hard, manly virtues and the desire for glory and heroism before comfort. Similar arguments were made before the war by authors such as Heinrich von Treitschke and during and after it by writers such as Ernst Jünger.

In fact such arguments have been a recurring feature of the politics of modernity, a point developed at length by Ian Buruma and Avishai Margalit in *Occidentalism*. However, the history of this division goes back further than their account does, and it reveals something profound both about historic human societies and the distinctive nature of the social order that we inhabit, that of modernity. The division between the merchant and other social types is found throughout history and is reflected and articulated in literature, music, and the arts. Only in recent times, however, has the merchant, the producer, the bourgeois found many champions.

In most human societies since the advent of agriculture and complex social organization, the merchant and manufacturer have been placed on the lowest rung of the social hierarchy. Even when members of this class attained wealth, political influence, and some degree of social standing, they were the butt of social criticism and ridicule. Above all, they were seen as less worthy than other social groups because of the morally questionable nature of their activities. Trade was seen as base, lacking in the crucial quality of honor.

Honor has been associated with the warrior, along with courage, daring, magnanimity, and generosity. The ideal aristocrat is open-handed, does not think of the future or have a cautious and prudent approach, is brave, proud, and sensitive to slights, yet generous and gracious in victory while defiant in defeat. Historically, the other figure contrasted with the bourgeois is that of the priest, or sage and holy man. The virtues ascribed to him are those of wisdom, asceticism, and respect for tradition.

By contrast, the merchant, or bourgeois, is seen as obsessed with money, comfort, and the affairs of this world; as cautious and fearful, lacking in passion or pride; and as unfeeling and introverted. Trade and production are seen as lacking in glory and romance and as being dull, domestic, and mundane. The small producer, the artisan or peasant, is also slighted in this way of thinking, but is still placed higher than the merchant. This is because he is seen typically as simple yet honest, while the merchant is seen as devious and cunning.

This kind of thinking finds expression in many ways. In pre-modern Japan the official social hierarchy was Emperor, Shogun, Daimyo, Samurai, Artisan/Peasant, Merchant. In Europe the socially ambitious bourgeois was mercilessly ridiculed, as for example in Molière's *Le Bourgeois Gentilhomme*. In India the merchant was seen as having an especially difficult task in accumulating merit, a view also found in both China and much traditional Christian thought (including of course the Gospels).

In representative art for much of history the main subjects were either mythological or the pastimes of aristocrats, notably war and the hunt. The merchant and his lifestyle are conspicuous by their absence. There are partial exceptions to this, of course. In China the Confucians have a minority tradition that is favorable toward merchants and producers, particularly under the Song

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and the later Ming. Initially, the Islamic civilization was actively favorable to trade and commerce, not least because the Prophet himself had been a merchant before his calling. However, the underlying sociology of most Islamic lands gradually reasserted itself, while in China more conventional Confucian views, which saw the career of the merchant as a barrier to virtue, were reiterated.

In certain parts of medieval and early modern Europe, particularly England, the Low Countries, and Northern Italy, the legal status of the bourgeois was higher than the historical norm, and this was reflected in a greater than usual degree of representation in literature and the arts. Even here, however, the bourgeois virtues, in Deirdre McCloskey's expression, were seen as less worthy than those of the warrior.

The critical change takes place in the Netherlands, during the "Golden Age" of the seventeenth century. At that time we see the first appearance of a truly mercantile culture, in which the values and lifestyle of the bourgeois are held up for approbation and emulation, while the virtues of the aristocracy and clergy are slighted and attacked. This finds expression in both literature and art, with its focus on domesticity, production, and trade rather than public religion and war. This expression was a feature of the Dutch Republic that most struck contemporaries, along with the independence of Dutch women and the degree of free speech and religious toleration. Above all, trade was presented as an honorable and dignified occupation, which brings benefits and blessings to humanity in the shape of convenience, comfort, and tranquility.

Le Bourgeois Gentilhomme

The Scottish Enlightenment

This kind of argument was developed further by the thinkers of the Scottish Enlightenment, notably Smith, Hume, and Lord Kames. They added the idea of the civilizing effect of commerce, the way it brought about a "softening" and "refining" of manners, behavior, and taste so that people acquired a greater degree of sensibility or sympathy with the experience and feelings of others and became less harsh, brutal, and overbearing. Wealth was seen therefore not as corrupting but rather as morally elevating and praiseworthy. This favorable view of the bourgeois and the associated critique of the traditional virtues of the aristocracy and clergy was continued in the first part of the nineteenth century, in the works of authors such as Stendhal, Dickens, and Balzac and composers such as Verdi.

However, the later nineteenth century saw a reaction, well described by Buruma and Margalit. In the sphere of music Wagner's *Ring* was among other things a savage attack on the values of the bourgeois, not least through the figure of Alberich. One striking aspect of the literature of the time was the reappearance of arguments for the virtue-creating function of war. As found in the writings of figures such as T.E. Hulme, this was one reason for the excitement and delight with which young intellectuals such as Rupert Brooke greeted the onset of war in 1914.

Today, while the kind of self-consciously reactionary argument made by Sombart is rare in much of the world, hostility to trade as demeaning and lacking in moral grandeur is common. The kind of arguments analyzed by Buruma and Margalit have now appeared prominently in the form of Islamism. Generally speaking, in popular culture the businessman is as disreputable as ever. One important reason for this is the changing perspective of artists. Between the early seventeenth and mid-nineteenth centuries many artists and writers were supporters of mercantile values against those of the aristocracy and clergy. In the later nineteenth century, however, many came to associate the life of the bourgeois with stultifying conformity, hypocrisy, and philistinism. The works of authors such as Ibsen and Flaubert are classic examples. There is no essential reason, however, why this should be so, and it reflects the particular features of late-nineteenth-century society. To reconcile the bourgeois and the artist is one of the tasks of our time.

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Basis of Liberty

BY DEAN RUSSELL

In one of his fables Aesop said: "A horse and a stag, feeding together in a rich meadow, began fighting over which should have the best grass. The stag with his sharp horns got the better of the horse. So the horse asked the help of man. And man agreed, but suggested that his help might be more effective if he were permitted to ride the horse and guide him as he thought best. So the horse permitted man to put a saddle on his back and a bridle on his head. Thus they drove the stag from the meadow. But when the horse asked man to remove the bridle and saddle and set him free, man answered, 'I never before knew what a useful drudge you are. And now that I have found what you are good for, you may rest assured that I will keep you to it.' "

The Roman philosopher and poet Horace said of this fable: "This is the case of him, who, dreading poverty, parts with that invaluable jewel, Liberty; like a wretch as he is, he will be always subject to a tyrant of some sort or other, and be a slave forever; because his avaricious spirit knew not how to be contented with that moderate competency, which he might have possessed independent of all the world."

Ever since man learned to write, one of his favorite subjects has been freedom and liberty. And almost always, it has been his own government that he most feared as the destroyer of his liberty. Further, various economic issues—primarily, the ownership of property and the control of one's time and labor—have always been listed prominently among the measurements of liberty.

Justice Sutherland of our Supreme Court clearly saw this connection when he said, "[T]he individual . . . has three rights, equally sacred from arbitrary interference [from government]: the right to his life, the right to his liberty, and the right to his property. These three rights are so bound together as to be essentially one right. To give a man his life, but deny him his liberty, is to take from him all that makes his life worth living. To give him his liberty, but to take from him the property which is the fruit and badge of his liberty, is still to leave him a slave."

Frédéric Bastiat, the French political economist of the last century, phrased the same idea another way: "Life, liberty, and property do not exist because men have made laws. On the contrary, it was the fact that life, liberty, and property existed beforehand that caused men to make laws in the first place."

A primary lesson of history is that liberty generally flourishes when goods are privately owned and distributed. I can find no example of real freedom for the people over a significant period of time when the means of production were mostly owned by the government, or by a restricted and self-perpetuating group who controlled the powers of government. In addition, material prosperity for the people in general has surged forward whenever the production and distribution of goods and services have been determined by the automatic processes of competition in a free market. And prosperity has faltered (and often failed completely) whenever governmental controls over the economic activities of the people have grown onerous. . . .

The late Dean Russell was a long-time member of FEE's staff and the author of Frédéric Bastiat: Ideas and Influence, The TVA Idea, *and* The Conscription Idea. *This article originally appeared in the Rockford (Illinois)* Morning Star *in January 1962 and in* The Freeman *in July 1962.*

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Book Reviews

Vienna and Chicago: Friends or Foes? A Tale of Two Schools of Free-Market Economics

by Mark Skousen
Capital Press • 2005 • 304 pages • $24.95 paperback

Reviewed by Richard M. Ebeling

In the post-World War II era, two of the leading voices for a return to a competitive free-market economy have been the Austrian and Chicago schools of economics. Both schools have influenced many people about how markets work and how government affects economic affairs.

To many, the Austrian and Chicago economists seem to be saying the same thing: markets are an efficient way of using scarce resources to best serve consumers; individuals know their own interests and circumstances better than government regulators and planners; political controls tend to distort supply and demand and the price system through which markets are kept in balance. In addition, members of both schools of thought have long warned that inflation and its negative consequences stem from government monetary mismanagement.

As a result, on the surface there seems not to be much difference between the two schools. Yet anyone fairly familiar with the Austrian and Chicago approaches knows that in fact they not only look at the world through significantly different conceptual lenses, they often are extremely critical of each other.

In his recent book, *Vienna and Chicago: Friends or Foes?*, Mark Skousen tries to explain the history of the Austrian and Chicago approaches, and critically evaluate their strengths and weaknesses. Skousen explains the beginnings of the Austrian school in the last decades of the nineteenth century, during which Carl Menger, Eugen von Böhm-Bawerk, and Friedrich von Wieser developed the theory of marginal utility and opportunity cost; formulated a theory of capital, investment, and interest; and undermined the foundations of Marxian economics. He then traces the contributions of such leading twentieth-century Austrians as Ludwig von Mises and F.A. Hayek in the areas of monetary and business-cycle theory, their insightful criticisms on socialist central planning, and their conception of the market as a dynamic competitive process.

The Chicago school developed later, in the 1920s and 1930s, out of the writings of Frank Knight, Jacob Viner, and Henry Simons, who were early critics of some aspects of Keynesian economics and of government planning. But the Chicago school only really flowered in the postwar era out of the contributions of Milton Friedman and George Stigler, who challenged, respectively, some of the rationales for macroeconomic and regulatory management of market activities.

For the remainder of the book, Skousen contrasts the two schools on a variety of topics, including methodology; inflation, business cycles and the monetary system; and government regulation and intervention. Somewhat irritatingly, Skousen concludes each section by declaring which school "wins the debate," using the language of tennis: "advantage" Vienna or Chicago. While seeming to be a cute way to evaluate the two schools, it comes across as rather sophomoric. Also, it often seems that Skousen's decision reflects his judgment about which school has been more influential among economists or in the policy arena. But the correctness of an idea is not measured, per se, by the number of its adherents. Alchemy and astrology have had wide followings, after all.

The core of the differences between the Austrian and Chicago schools is the question of how one tries to understand the world, including the market. Imagine that two objects are observed moving toward each other at a certain velocity. What can we predict about what will happen? Well, we can attempt to estimate their respective speeds and calculate when they are likely to collide, given the measured space between them.

There is nothing wrong with doing this. But if the two objects happen to be human beings, limiting the "facts" or "evidence" to these quantitative dimensions will leave out crucial features of the situation. For example, do these individuals view each other as friend or foe? The answer to that question alone will greatly influence what we predict as the likely sequence of events as they come closer to each other. (If foe, one of them

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might suddenly stop dead in his tracks and run in the oppose direction from fear.)

To analyze this situation requires the social scientist or economist to look beneath the quantitative surface to try to determine how the actors define the situation, including the meanings they see in their own actions and those of others with whom they may interact. A voluntary exchange and a coerced transfer may look the same to an observer. But they are certainly not the same when understood from the perspectives of the actors.

Unlike the Chicago-school economists, the Austrians have always insisted on emphasizing this "subjectivist" approach. This is partly due to the Chicagoans' continuing belief (a subjective state of mind, for sure!) that "science" should be defined narrowly as the quantitatively measurable and predictable.

Skousen tries to reduce and ridicule the Austrian view by making it into a caricature of an "a priori-deductive" approach that is both incorrect and unjust to the actual arguments that Austrians like Mises developed in great detail. Nor does Skousen do justice to the fact that Austrians, too, believe in "applied" economics, historical studies, and factual evidence. They just do "empirical" work differently from the Chicago economists—the Austrian approach tries not to forget that it is the course of *human* events that is being investigated.

He therefore too easily gives "advantage" to the Chicago school when comparing their contributions, for instance, in the area of government regulation. The Austrians focus on the entrepreneurial element of innovation and market coordination; they think of competition as a creative discovery procedure; and they view markets as processes of change and adjustment through time. To appreciate the power of the unregulated market, none of these aspects of the real "empirical" world can simply be reduced to econometric coefficients of correlation without losing essential qualities of the subject. It would be like trying to study man by looking only at the skeleton and ignoring the flesh, blood, muscles, nerve endings, and most especially, the *mind* that guides what the body does.

Skousen finds the most important Austrian contributions in the areas of money, inflation, the business cycle, and monetary institutions. This should not be surprising since these are the areas in which he has written the most over the years from an Austrian-oriented perspective. Friedman's monetary contributions have basically followed in the Keynesian footsteps. While rejecting most of Keynes's assumptions about the power of fiscal policy for stimulating the economy, Friedman accepted his "aggregate" approach of looking almost purely at money's impact on prices, wages, and output in general.

The Austrians, on the other hand, have always focused on the more insidious effects of monetary expansion on relative prices and wages, and on demand, effects that can give a wrong twist to the entire economy.

Unfortunately, while an easy read and even entertaining in places, *Vienna and Chicago* fails to give the reader a fully balanced understanding of the Austrians or a sufficiently critical appreciation of the limits of the Chicago school.

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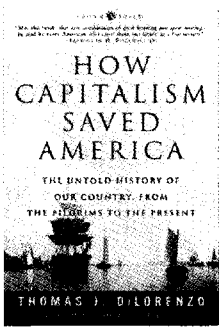
How Capitalism Saved America: The Untold History of Our Country, from the Pilgrims to the Present

by Thomas J. DiLorenzo

Crown Publishing • 2004/2005 • 295 pages • $25.95 hardcover; $14.95 paperback

Reviewed by Robert Batemarco



Professor Thomas DiLorenzo of Loyola College, Maryland, has managed to pack two books into the volume titled *How Capitalism Saved America*. The first is the work promised in the title, the inspiring story about the creative power of that nexus of voluntary exchanges known as capitalism. The second, more sobering, book inhabiting these same pages tells the tawdry tale of those who through venality, envy, or simple ignorance have acted to stifle capitalism and deprive us of its benefits. Unfortunately, this second is as necessary as the first.

The "first book" is replete with unsung heroes, such as industrialist Thomas Weston and nobleman Thomas Dale. These two Englishmen observed, diagnosed, and treated the free-rider problem that subjected the

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Jamestown and Plymouth Bay colonies to impoverishment, famine, and death. Their prescription was not, as today's conventional economic wisdom would have it, enlisting the government to provide food, but rather replacing communal property rights with private property rights. Within a year, poverty was succeeded by plenty, initiating a process that would make America the wealthiest country the world had ever known.

The "second book" shows that identity theft has been a problem since long before the Internet, credit cards, and Social Security numbers. The culprit here is mercantilism and the victim capitalism. Few who have not studied the history of economic thought even know what mercantilism is, a problem that wide readership of this book would remedy. Yet this system, in which the state extracts large amounts of resources from the populace to subsidize favored corporate interests, is what most people think capitalism is. This deception has led to a double injustice: the vilification of market entrepreneurs whose wealth came from solving the problems of millions within the capitalist system and the hailing as the "saviors of capitalism" politicians who conjure up phony problems or phony solutions to real problems.

DiLorenzo sets this out clearly and provides many historical examples. For instance, he contrasts the private road systems that sprang up throughout the United States in the early 1800s with the "public improvements" subsidized by state governments that were so corrupt and inefficient that by 1860 most states had banned such boondoggles. Unfortunately, after the Civil War the newly empowered central government picked up where the states left off by subsidizing railroads. While most historians paint all railroad owners as "Robber Barons," this book makes the crucial distinction between market entrepreneur and political entrepreneur to separate the Vanderbilts and the Hills from politically connected railroad magnates such as Jay Cooke and Thomas Durant, who were truly deserving of that ignominious title.

This book elucidates many other examples of capitalism delivering the goods while its opponents fraudulently take the credit. For one, it demonstrates how capitalism enriched the working class through that most capitalist practice, capital accumulation, while union leaders and politicians claimed their beloved income-redistribution policies had done the trick—and some trick it would have been, since you cannot redistribute what has not been produced. For another, it illustrates how capitalism, in the person of the entrepreneur John D. Rockefeller solved the problem of providing cheap energy, enabling supply to grow and price to fall year after year. Simultaneously, nearly every measure promulgated by the government to tame the "excesses" of capitalist production of oil, including antitrust prosecutions, worked against the interests of consumers. Especially worthwhile is the discussion of the antitrust bait-and-switch scam, which promises to promote competition while actually seeking to rein in those who compete too successfully.

Finally, no discussion of how government problem-solving makes matters worse would be complete without surveying its sorry record of ameliorating the business cycle. DiLorenzo's detailed analysis of the policies adopted from the onset of the Great Depression obliterate any justification for believing that Herbert Hoover was a practitioner of capitalism and Franklin Roosevelt was its savior.

The author writes with a clarity and passion rare for economists. *How Capitalism Saved America* is scholarly yet accessible. While not theoretical, it uses theory to help us understand the facts. I did note a couple of inaccuracies, however. For example, the author says a worker must generate at least as much *profit* as the wage he is paid, when he means *revenue*. He also confounds the First and Second Banks of the United States. While neither of these undermines the main themes of this powerful work, they are the kind of errors that will be pounced on by those who cannot counter his arguments on the merits.

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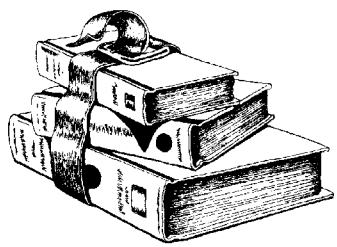

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Go Directly to Jail: The Criminalization of Almost Everything

Edited by Gene Healy
Cato Institute • 2004 • 151 pages • $17.95

Reviewed by George C. Leef

In the gigantic theater that is American politics, one of the favorite roles for politicians to play is that of the tough guy who is determined to "crack down" on something or other. Such actions are predictably cheered by whatever voting groups the politician wants to curry favor with. An often-heard campaign line is, "Vote for me and I'll push legislation to make it a crime to. . . ." We already have an enormous criminal code, but adding one more thing to it serves to show the voters that the pol really means business.

Like most features of our politics this mania for the criminalization of behavior is harmful. As is usual with government, the unseen problems dwarf the seen benefits. The more we criminalize conduct that voters dislike, the more we put people who never intended any wrongdoing into the quicksand of criminal prosecution. With legions of prosecutors who are more interested in making names for themselves than in doing justice, Americans are living in an increasingly dangerous country.

That's the point of *Go Directly to Jail*, edited by lawyer and Cato Institute writer Gene Healy. "At one time," he writes, "the common law doctrines of *mens rea* ("guilty mind") and *actus reus* ("guilty act") cabined the reach of criminal sanctions, but those protections have eroded dramatically over the past 50 years. Today it's possible to send a person to prison without showing criminal intent or even a culpable act. . . ."

Consider this case. Edward Hanousek worked for a railroad in Alaska. One day, a backhoe operator working under his supervision accidentally ruptured an oil pipeline while removing some boulders from the tracks. Hanousek, who wasn't even at the site of the accident, was nevertheless prosecuted for having violated the Clean Water Act, which makes it a crime if a "negligent failure to supervise" leads to any discharge that might pollute water. Hanousek was convicted for someone else's accident. His case was appealed to the Supreme Court, which declined to review this legal abomination. Americans must now worry about criminal prosecution for all sorts of conduct that a few decades ago hardly anyone would have thought should be illegal.

The book has six chapters by different authors. Erik Luna's "Overextending the Criminal Law" explores the unfortunate tendency for politicians to use criminal sanctions as an all-purpose tool of social control. It's impossible to disagree with Luna's assessment that "When the criminal sanction is used for conduct that is widely viewed as harmless . . . the moral force of the penal code is diminished, possibly to the point of near irrelevance. . . ."

In the second essay, "The New Criminal Classes: Legal Sanctions and Business Managers," James V. DeLong observes that the spread of criminalization means that nearly anyone can fall victim to prosecution for some regulatory crime, and often the defendant finds that the law accords him a lower degree of protection for his rights than do old-fashioned criminals who rob and murder. The Fourth and Fifth Amendments have been subverted in the crusade to send people like Ed Hanousek to jail.

Legal scholar Timothy Lynch, in "Polluting Our Principles: Environmental Protection and the Bill of Rights," shows that the incentives for environmental regulators to produce "results" (that is, convictions to prove how dedicated they are to safeguarding the environment) lead to terrible travesties of justice. The vagueness of many environmental regulations gives the enforcers almost unfettered discretion to prosecute businesspeople. Lynch notes that individuals accused of environmental crimes are often subjected to procedures that the courts would not tolerate for normal criminal defendants. He calls it the "environmental exception to the Bill of Rights."

Galen Institute president Grace-Marie Turner discusses criminalization in medical care, specifically, the dangerous trend toward criminal prosecution in the futile crusade against Medicare and Medicaid fraud. An especially frightening feature of the law here is that the enforcers get to keep a percentage of the fines they impose.

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Editor Healy contributes a chapter on the rampant federalization of crime. To provide just one example, President Bush's Project Safe Neighborhoods has led to a surge in federal prosecutions for illegal firearms possession. Healy writes that this law "violates the Tenth Amendment, clogs the federal courts, encourages a mindless zero tolerance policy and opens the door for every special interest group in Washington to politicize criminal justice policy."

The book's final chapter, again by Erik Luna, examines the nation's sorry experience with federal sentencing guidelines, which he argues "saps moral judgment from the process of punishment."

The U.S. is off track in many, many ways. *Go Directly to Jail* leaves no doubt that our legal system is careening out of control and poses a grave threat to our liberty.

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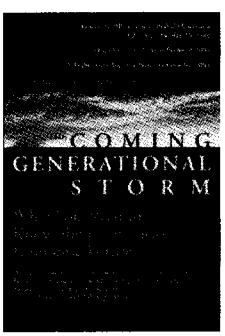
The Coming Generational Storm: What You Need to Know about America's Economic Future

by Laurence J. Kotlikoff and Scott Burns
MIT Press • 2004/2005 • 274 pages • $22.00 hardcover; $16.95 paperback

Reviewed by Christopher Westley



Boston University's Laurence Kotlikoff is a serious scholar who has devoted much of his professional life to examining Social Security. What he writes on this issue it's wise to read. *The Coming Generational Storm*, co-authored with Dallas-based financial columnist Scott Burns, is a worthwhile book.

Their description of the fiscal nightmare known as Social Security is a must-read for both academics and interested laymen. It's a credit to Kotlikoff and Burns that they can produce a page-turner for both groups, despite some technical sections on general equilibrium, intergenerational accounting, and actuarial science.

The picture they paint isn't pretty. Social Security is in crisis because it's organized as an intergenerational wealth-transferring scheme in which the assets of workers are turned over to current retirees. It's a welfare program, pure and simple, but a unique one in that it gets its own special tax—a tax on labor.

It is also unique because since the late 1960s Social Security *expenditures*—though not its revenues—have been off-budget, an accounting rule that would never be tolerated in the private sector where investors would punish such deceit. But it is one that serves the government's needs because it understates budget deficits year to year. For decades Social Security has allowed the feds to appear less fiscally irresponsible than they really are.

The authors note that at Social Security's creation, 16 workers supported each retiree. That ratio was achieved because the labor force was so young and because old-timers just didn't get that old. (The late John Attarian pointed out that the New Dealers' purpose in Social Security was no higher-minded than to get older workers to leave the workforce. Their presence was blamed for the failure of New Deal programs to reduce unemployment.) Those were Social Security's glory days.

But life expectancy has been rising and the worker-to-retiree ratio has been falling. Result: The ratio now stands at 3:1, and over the next 30 years, the figure is expected to fall to 2:1. The longer reforms are put off, the greater the burden placed on future generations to pay for current spending, and it is here that Kotlikoff and Burns make their most compelling case. We have long been told that the national debt represents spending to be paid for by future generations, but we are rarely told that the special accounting rules applied to Social Security (and Medicare/Medicaid) mask the debt's actual size. In truth, the fiscal gap—defined as the present value difference between the government's expected expenditures and receipts—is $45.5 trillion. This is six times higher than the official national debt figure.

Kotlikoff and Burns note that this is the government's number—well-hidden in the fine print of Treasury documents—and that it's probably a low-ball estimate. What's more, it was computed before passage of the new Medicare drug benefit. That massive expansion promises to increase the fiscal gap to over $51 trillion. Each year that these programs or the tax system that funds them are not reformed, the fiscal gap grows by $1 trillion.

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The book's chief shortcomings are two. The first is in Kotlikoff and Burns's personal saving system. While their approach improves on the various proposals currently being discussed in Washington, it still maintains the form of a compulsory saving program with the inherent assumption that individuals are incapable of planning for their own retirement.

Why not simply abolish Social Security outright, cut everyone's taxes, slash spending, and allow the market to work? There would be more jobs available for workers in short order, resulting in increased wealth creation and greater self-sufficiency across society. (Provision for current retirees does not require continuation of this failed system.)

A second problem with the authors' approach is that their description of the future and proposed solution assume that the size and continuing growth of the state won't change. But it seems likely that as Social Security inflicts more costs on the economy, some of the burden of big government will become harder to hide from the masses. The result will be a crisis for politicians, who will find it harder to redistribute wealth. For the majority of Americans, who are net taxpayers (as opposed to net tax consumers), the crisis may actually be an opportunity to highlight the bankruptcy of the state, in both theory and in real life.

While their book is flawed, Kotlikoff and Burns should be applauded for calling attention to Social Security's moral and financial bankruptcy.

Christopher Westley (cawestley@email.msn.com) is an assistant professor of economics at Jacksonville State University.

Coming in the December issue of *The Freeman*

Paying High Gas Prices and Abolishing FEMA Would Help Disaster Victims
Dwight R. Lee

Repeal Davis-Bacon
George C. Leef

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Burton Folsom, Jr.

U.S.-China Relations after CNOOC
James A. Dorn

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Supply, Demand, Inventory

BY RUSSELL ROBERTS

Supply-and-demand analysis is the bread and butter of classroom economics. All over America as the leaves change color and college commences, professors of economics are shifting supply and demand curves and showing how the price of a good changes in response.

There are no supply and demand curves in the real world. Yet supply-and-demand analysis is a powerful framework for organizing one's thinking about how changes in behavior ripple through the economy, leading to changes in prices and in turn affecting the choices made by buyers and sellers.

F.A. Hayek, in his classic 1945 article from the *American Economic Review*, "The Use of Knowledge in Society" (available at www.econlib.org/library/Essays/hykKnw1.html), described how the change in price in response to a change in demand or supply conveys information and induces buyers and sellers to respond in ways that would be difficult if not impossible to achieve in a centralized, hierarchical situation:

> Assume that somewhere in the world a new opportunity for the use of some raw material, say, tin, has arisen, or that one of the sources of supply of tin has been eliminated. It does not matter for our purpose—and it is very significant that it does not matter—which of these two causes has made tin more scarce. All that the users of tin need to know is that some of the tin they used to consume is now more profitably employed elsewhere and that, in consequence, they must economize tin. There is no need for the great majority of them even to know where the more urgent need has arisen, or in favor of what other needs they ought to husband the supply.

Yet out in that real world, do prices really play the role that Hayek and other economists claim?

People eat more pizza on Super Bowl Sunday than on any other day of the year. I suspect people also eat more hot dogs and chili on that day. I'd also guess that beer sales are in the top five along with New Year's Eve, July 4, Memorial Day, and Labor Day.

But despite the massive surge in demand for pizza dough, hot dog buns, and beer on that single day, the prices of those items are no higher on Super Bowl Sunday. If anything, they're *lower* than usual as grocers and others try to attract customers.

How do we reconcile this phenomenon with the standard textbook understanding of supply and demand? Increases in demand should lead to increases in price.

The simple answer is that pizza dough and hot dog buns can be stored. The dough and the buns can be frozen with little loss of quality. If the price were high on Super Bowl Sunday, there would be an arbitrage opportunity, an opportunity to make money by storing supplies when demand is low and selling them when demand is high. This storage opportunity smoothes the prices so that the day before and the day after, they are roughly the same.

This story is okay as far as it goes, but it points to an insight about markets we frequently ignore in teaching supply and demand—the role of inventory in smoothing price fluctuations in the face of shifting supply and demand whether predictable or unpredictable.

My George Mason colleague Walter Williams says it better than I can: "Here's my relationship with my grocery store. I don't tell them when I'm coming. I don't tell them what I want to buy. I don't tell them how much I'm going to buy. But if they don't have what I want when I show up, I fire 'em."

This is our relationship with most suppliers in the modern American economy. We expect the shelves to be

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stocked, and they usually are. We pay a small ongoing premium for this availability. The carrying costs of those inventories aren't free. But we prefer paying that premium to finding empty shelves and incurring the time costs of finding the product somewhere else.

Inventories are a way sellers compete by providing the certainty of availability. As Williams's story illustrates, this form of competition doesn't confer a competitive edge. Rather, it becomes a necessity for a firm that wants to stay in the marketplace.

In recent years part of the success of big-box retailing is a story of the power of inventory and availability. Book lovers prefer the 100,000 titles carried by Borders and Barnes and Noble to the charm of the smaller independent stores. Home Depot and Lowe's have driven smaller independent hardware stores out of business with lower prices. But the range of available products is a huge part of their success as well.

Inventories are a way sellers compete by providing the certainty of availability.

So are all those professors wasting their students' time teaching them a tool, supply and demand, that is only a curiosity?

No—the ability to use inventory in response to changes in demand is limited by the costs of holding that inventory. For anticipated changes when inventory is relatively inexpensive, such as on Super Bowl Sunday, the increase in demand does not translate into an increase in price.

But when holding inventory is difficult, expensive, or impossible, the full impact of demand changes is reflected in the price. The price of roses on Valentine's Day or the day before is much higher than at other times of the year because flowers cannot be stored like beer or frozen like pizza dough.

Limited Role for Inventory

The price of houses in the Washington, D.C., area reflects the increase in the size of government as government employees and government office space drive up the price. The only role for inventory in such a situation is the building of housing in increasingly distant suburbs. Travel time reduces the ability of these expanded opportunities to meet the increase in demand. The price of housing rises in the areas closer to the city.

Travel time in a city such as Washington, D.C., is another example of how price rather than inventory clears the market. Because the roads are public property not owned by anyone, time spent traveling caused by congestion is the price that clears the market rather than an out-of-pocket payment. It is physically impossible to add supply at peak times. You can't store extra lanes or freeze them. So traveling at rush hour takes longer than at other times. If someone did own the roads, the price would be higher during peak travel times.

Over time, as more people move into metropolitan areas such as Washington, D.C., the time it takes to commute there also climbs inexorably. This time cost only falls when new roads are built or existing roads are widened. But if demand continues to rise, travel time for any particular commute will again begin to climb.

And prices matter even in a world where inventory is possible. They matter in the short run because not all markets can meet short-run fluctuations where inventory is costly. These fluctuations in price in turn induce innovation as a form of competition, to reduce both the cost of production and the cost of providing inventory.

Time spent understanding supply and demand remains time well spent.

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